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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR (1) APPROVAL OF THE PURCHASE OF GENERATING ASSETS FROM PPL SUNDANCE ENERGY, LLC AND FOR (2) AN ACCOUNTING ORDER AND DETERMINATION OF RATEMAKING TREATMENT.	DOCKET NO. E-01345A-04-0407
IN THE MATTER OF THE APPLICATION OF SUNDANCE ENERGY IN CONFORMANCE WITH THE REQUIREMENTS OF ARIZONA REVISED STATUTES 40-360.03 AND 40.360.06, FOR A CERTIFICATE OF ENVIRONMENTAL COMPATIBILITY AUTHORIZING THE CONSTRUCTION OF A NOMINAL 600 MW NATURAL GAS-FIRED, SIMPLE CYCLE, PEAKING POWER GENERATING FACILITY IN PINAL COUNTY, ARIZONA SOUTHWEST OF COOLIDGE, ARIZONA.	DOCKET NO. L-00000W-00-0107

Decision No. 67504

OPINION AND ORDER

DATE OF HEARING:	October 4 and 5, 2004
PROCEDURAL CONFERENCES:	August 18, 2004 and September 30, 2004
PLACE OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Teena Wolfe
IN ATTENDANCE:	Chairman Marc Spitzer Commissioner Kristin K. Mayes
APPEARANCES:	Mr. Thomas L. Mumaw and Ms. Karilee S. Ramaley, PINNACLE WEST CAPITAL CORPORATION, and Mr. Jeffrey B. Guldner and Ms. Kimberley A. Grouse, SNELL & WILMER, LLP, on behalf of Arizona Public Service Company; Mr. Jay I. Moyes, MOYES STOREY, LTD, and Mr. Jesse A. Dillon, Senior Counsel, PPL Services Corp., on behalf of PPL Sundance Energy, LLC; Mr. Walter W. Meek, President, Arizona Utility Investors Association;

Mr. Lawrence V. Robertson, Jr., MUNGER CHADWICK, PLC, on behalf of Sempra Energy Resources and Mesquite Power, LLC, and on behalf of Southwestern Power Group II, LLC and Bowie Power Station, LLC;

Ms. Laura Sixkiller, ROSHKA HEYMAN & DEWULF, on behalf of Tucson Electric Power Company;

Mr. Daniel Pozefsky, Staff Attorney, on behalf of the Residential Utility Consumer Office; and

Ms. Janet Wagner and Mr. Jason Gellman, Staff Attorneys, Legal Division, on behalf of the Arizona Corporation Commission's Utilities Division Staff.

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BY THE COMMISSION:

PROCEDURAL HISTORY

On June 1, 2004, Arizona Public Service Company ("APS") and PPL Sundance Energy, LLC ("PPL Sundance") filed a Joint Application requesting approval of the Arizona Corporation Commission ("Commission") for the purchase by APS of the Sundance Generating Station and associated assets ("Sundance Plant"), requesting authorization of ratemaking treatment for the assets being acquired by APS, requesting an accounting order authorizing APS to defer for future recovery a portion of the capital and operating costs associated with the acquisition, net of cost savings to APS from the acquired assets, requesting clarification or modification of a condition in the Certificate of Environmental Compatibility ("CEC") granted to Sundance PPL, and requesting confirmation that the CEC is valid and effective.

Intervention was requested by and granted to the Residential Utility Consumer Office ("RUCO"), the Arizona Utility Investors Association ("AUIA"), Tucson Electric Power Company ("TEP"), Southwestern Power Group II, LLC, Bowie Power Station, Sempra Energy Resources and Mesquite Power LLC (collectively "Sempra/Southwestern"), Constellation NewEnergy, Inc. and Strategic Energy, LLC.

On August 10, 2004, the Commission's Utilities Division ("Staff") filed a Request for Procedural Order, setting forth proposed procedural dates.

Following a procedural conference held on August 18, 2004, a Procedural Order was issued on August 20, 2004, setting procedural deadlines for publication of notice of the hearing, for intervention, for discovery, and for the filing of testimony, and setting a hearing date on the application for October 4, 2004.

The hearing was held as scheduled. APS, PPL Sundance, AUIA, TEP, Sempra/Southwestern, RUCO and Staff appeared through counsel, and APS, PPL Sundance, AUIA, RUCO and Staff presented evidence.

Following the filing of late-filed exhibits and an opportunity for comment thereon, and the filing of initial and reply closing briefs, this matter was taken under advisement by the presiding Administrative Law Judge pending the submission of a Recommended Opinion and Order to the

Commission.

RELIEF REQUESTED

In the Joint Application, APS and PPL Sundance requested:

I. Approval of the transaction;

II. Determination that the acquisition is prudent and that the plant is used and useful;

III. Confirmation that the Sundance Plant will be afforded traditional cost of service treatment in the future;

IV. Confirmation that APS' existing financing authority can be used to finance the acquisition;

V. A deferred accounting order authorizing APS to defer for future recovery a portion of the capital and operating costs associated with the acquisition of the Sundance Plant, net of cost savings to APS from the acquired assets; and

VI. Modification of one condition in the CEC issued for the Sundance Plant to conform it to more recent CECs and confirmation that the CEC is currently valid and effective.

BACKGROUND

APS conducted a request for proposals ("RFP") process in which it evaluated bids from non-affiliated merchant generators and power marketers, including both purchased power agreements and asset sales, to determine opportunities to address APS' resource needs (Joint Application at 2-3). APS announced its plans to conduct the RFP on November 19, 2003, and formally issued an RFP on December 3, 2003 (Direct Testimony of Patrick Dinkel, Exh. APS-4 at 5). Nine interested generators and energy marketers attended a bidders' conference APS held on December 13, 2003, during which APS provided an overview of the RFP, gave a presentation on transmission capacity, and responded to questions (*Id.*). Bidders submitted responses by January 21, 2004, and APS notified short-listed bidders, including PPL Sundance, in mid-February 2004 (*Id.*). The Sundance Plant was the only peaking resource that participated in the RFP, and is the only constructed or permitted simple-cycle plant available in the Arizona market today (Direct Testimony of Steven M. Wheeler, Exh. APS-1 at 4). On June 1, 2004, the same date on which the Joint Application was filed, APS entered into an Asset Purchase Agreement with PPL Sundance (Asset Purchase Agreement, Exh. APS-2). A copy of

the Asset Purchase Agreement, which was admitted to the record as Hearing Exhibit APS-2, is attached to this Decision as Exhibit A.

PPL Sundance owns and operates the Sundance Plant, which is a 450 megawatt, natural gas-fired, simple cycle, peaking electrical generating facility located in Pinal County, approximately five miles southwest of Coolidge, Arizona (Direct Testimony of Bradley E. Spencer, Exh. PPL-3 at 3). PPL Sundance is an "exempt wholesale generator" and the Sundance Plant is an "eligible facility," each within the meaning of Section 32(a) of the Public Utility Holding Act of 1935 (*See* Asset Purchase Agreement, attached hereto as Exhibit A, at 14). Power generation at the Sundance Plant consists of ten General Electric LM6000 Sprint 45 MW combustion turbines arranged in pairs along with five generation step-up transformers (Exh. PPL-3 at 3). Subject to the construction of additional transmission and certain other conditions, the permits to be transferred to APS under the Asset Purchase Agreement may allow for expansion of the plant to 540 MW from its current nameplate capacity of 450 MW (*Id.* at 4).[1] The Sundance Plant's generation units are of the type typically used to meet peaking capacity needs because of their ability to start up in less than ten minutes from a warm or cold standby condition compared to five or seven hours for a typical combined cycle unit (Exh. APS-4 at 9).

The Sundance Plant's on-site support infrastructure includes an administration building, warehouse storage, demineralization water treatment facilities, gas conditioning equipment, two groundwater wells, two raw water storage ponds, three storm water retention ponds, a reverse osmosis byproduct water collection pond, and an irrigation re-use distribution system and associated fields (Exh. PPL-3 at 3). The Sundance Plant is connected by multiple new 230 kV transmission lines to the Western Area Power Administration ("WAPA") transmission grid at WAPA's Coolidge substation, which is located approximately eight miles from the plant (*Id.*). Natural gas can be supplied from El Paso Natural Gas Company pipelines that cross the property and are interconnected to the Sundance Plant, and water for the plant is supplied primarily from the Central Arizona Project (*Id.* at 3-4).

[1] The "self-build" provisions of the settlement agreement in APS' pending rate case (Docket No. E-01345A-03-0437), if adopted, would also govern APS' ability to expand the Sundance Plant (*See* Tr. at 92).

The Sundance Plant was placed into service in July 2002 (Exh. APS-4 at 9). APS has been purchasing capacity and energy from the Sundance Plant since it went into commercial operation and currently has several contracts with PPL Sundance for peaking resources, totaling 225 MW of capacity (Exh. APS-1 at 16).

DISCUSSION

I. Approval of the Transaction

A. Approval or Clarification of Authority

The Joint Application requests approval of APS' purchase of the Sundance Plant. APS states that regulatory uncertainty has prompted it to seek approval of its purchase of the Sundance Plant (APS Initial Br. at 4). APS believes that this Commission's Track A and Track B Decisions[2] and the current unresolved status of the Electric Competition Rules being reviewed at the Arizona Supreme Court[3] create uncertainty concerning APS' ability to acquire new generation resources (*Id.* at 5). PPL Sundance agrees, and believes that the Commission should answer, in this proceeding, the question of whether or not the APS acquisition of the Sundance Plant complies with prior Commission Orders (PPL Sundance Br. at 8-9). AUIA also believes that uncertainty and confusion exist regarding APS' power supply options after the Track A and Track B Decisions (Direct Testimony of Walter W. Meek, Exh. AUIA-1 at 8), and contends that the Commission's overall approval of the transaction, along with the issuance of an accounting order, are critical to completion of the transaction (*Id.* at 2).

APS believes that its request for regulatory clarification should be granted, regardless of what action is taken on its request for a prudence determination in this proceeding (APS Reply Br. at 2). In support of its request for approval of the transaction, APS states that the approval it requests for the acquisition is separate and distinct from the prudence and used and useful determination that it also seeks for the Sundance Plant, and that the Commission could "approve" the transaction as APS requests, without making a prudence or used and useful determination (APS Br. at 4, fn 1; APS Reply Br. at 2). APS argues that the Commission has historically approved major resource acquisitions by

[2] Decision No. 65154 (September 10, 2002) and Decision No. 65743 (March 14, 2003).

[3] A petition for review of the Arizona Court of Appeals decision in *Phelps Dodge, et al. v. Arizona Elec. Power Coop.*, 1CA-CV 01-0068 (March 15, 2004 amended op.), which overturned some, but not all, of the Commission's Electric Competition Rules, was filed with the Arizona Supreme Court on May 4, 2004, and is currently pending.

APS;[4] and that when APS constructed new resources in the past, this Commission had "several opportunities" to provide guidance or endorsement of those efforts in CEC and financing authorization proceedings (APS Br at 4). APS contends that this Commission routinely grants "approvals" to utilities acquiring assets in financing application decisions and to utilities constructing assets during CEC proceedings, and that such approvals do not constitute "premature rate case relief" (APS Reply Br. at 3).

PPL Sundance argues that reasonable minds may differ regarding the application of the Track A and Track B Orders to any specific case of generation asset procurement, and asserts that uncertainty must exist, or else there would not have been a need for language in the proposed settlement agreement in APS' pending rate case confirming APS' ability to self-build or acquire generation plant (PPL Sundance Br. at 8).

Sempra/Southwestern argues that there is no demonstrable harm in pre-authorization of the acquisition as long as the deferral order language recommended by Staff[5] is adopted (Sempra/Southwestern Reply Br. at 5).

RUCO opposes pre-approval of ratemaking treatment and approval of an accounting order, but takes no position on Commission approval of the transaction (RUCO Br. at 2).

Staff states that the Track A and Track B Orders nowhere expressly prohibit APS from purchasing or building generation facilities, and contends that APS' claims regarding the potential uncertainty stemming from the Track A and Track B Orders are exaggerated (Staff Br. at 3). In support of this contention, Staff points to the following recent APS actions that Staff believes appear to be based on traditional regulatory principles, following the Track A and Track B Orders: 1) APS' issuance of the RFP soliciting offers for the sale of generation assets; 2) APS' pending 2003 rate case request in general, which was prepared using cost-of-service principles; and 3) the pending 2003 rate case request for rate base treatment of certain generation assets owned by its affiliate (*Id.*). Staff posits that it would not object to an appropriate clarification, if it were determined that the Track A

[4] In support of this argument, APS cites the Pacificorp Diversity Exchange case, Decision No. 57479 (July 11, 1991), the Salt River Project Territorial and Contingent Agreement, Decision No. 29505 (March 13, 1956), and the Commission's resource solicitation requirements set forth in the Track B Order, Decision No. 65743 (March 14, 2003).

[5] *See* Exhibits to Staff's October 19, 2004 filing are attached to this Decision as Exhibit C.

and Track B Orders do create "regulatory uncertainty," but cautions that APS should not be allowed to obtain premature rate case relief by use of its "regulatory uncertainty" claim (*Id.*). Staff recommends that, if it is determined that clarification of the Track A and Track B Orders is warranted, any clarification should be limited to the issues that are allegedly unclear (Staff Cl. Br. at 4). Staff believes that adoption of paragraph 83 of the proposed settlement agreement[6] in the pending APS rate case would eliminate the uncertainty that APS believes exists (Direct Testimony of Matthew Rowell, Exh. S-3 at 13), and that it would not be inappropriate to include similar language in this Decision, if necessary (Tr. at 367, Staff Cl. Br. at 4).

We are not convinced by APS' arguments that, because this Commission routinely grants financing applications and CEC applications when applicants are constructing facilities, we should issue an "approval" of the acquisition in this case. While APS is correct that Commission Orders granting CECs do grant authority to construct assets, such Orders do not address the ratemaking treatment of such assets. And while the premise of APS' argument that the "approvals" this Commission routinely grants to utilities acquiring assets in financing application decisions do not constitute "premature rate case relief" is correct, the "approval" that APS seeks here is not approval to obtain financing, but approval of the acquisition itself. Commission Orders granting financing authority do not approve asset acquisitions, but reserve review of acquisitions for a rate case, which is the proper vehicle for approval of acquisitions. This Commission's financing Orders routinely state that financing approval does not constitute approval or disapproval of any particular expenditure of the financing proceeds for purposes of establishing just and reasonable rates.

APS also contends that its acquisition of the Sundance Plant could be "approved" without a prudence or used and useful determination. In this same case, however, APS and PPL argue that the Commission has available to it, in this proceeding, all the facts and evidence necessary for a prudence determination under Commission rules (Tr. at 14, 83; PPL Sundance Br. at 5, 9-10). It is highly

[6] Paragraph 83 of the proposed settlement agreement filed on August 18, 2004 in APS' pending rate case in Docket No. E-01345A-03-0437 provides as follows: "83. The Parties further acknowledge that APS currently has the ability, subject to applicable regulatory requirements, to self-build or buy new generation assets for native load, subject to paragraph 81, and subject to the conditions in Section IX of this Agreement." Paragraph 81 provides: "The Parties acknowledge that APS has the obligation to plan for and serve all customers in its certificated service area, irrespective of size, and to recognize, in its planning, the existence of any Commission direct access program and the potential for future direct access customers. This section does not bar any Party from seeking to amend APS' obligation to serve."

likely that having once "approved," outside a rate proceeding, an asset acquisition by a regulated entity which claims all the information required for a prudence determination is available, a regulator might encounter difficulty determining prudence on a *de novo* basis in a future rate proceeding. The ratemaking quandary that would result from Commission approval of the acquisition in this non-ratemaking proceeding appears to be what RUCO and Staff caution against as "granting premature rate relief." The circumstances of this case do not justify the ratemaking predicament that approval of the acquisition outside of a rate proceeding would bring about. We find that it would therefore be very unwise, and not in the public interest, to grant "approval" of the acquisition as requested in the Joint Application.

It would not be inappropriate, however, to include language in this Decision to dispel any uncertainty or confusion regarding APS' current ability to self-build or buy new generation assets for native load. We agree with Staff that adoption of language regarding APS' current ability to self-build or buy new generation assets for native load, similar to that set forth in paragraph 83 of the proposed settlement agreement in the pending APS rate case, would eliminate the uncertainty that some parties believe exists, and we will include such clarifying language in this Decision.

B. Effect on FERC Approval Proceeding

The Sundance Plant includes some interstate transmission facilities which are subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC") (*see* Tr. at 121), and therefore FERC approval of the acquisition is required under Section 203 of the Federal Power Act. APS and PPL Sundance contend that Commission approval, or affirmative validation, of the transaction will support APS' and PPL Sundance's application at FERC for the required approval of the transfer of the Sundance Plant to APS (APS Br. at 7; PPL Sundance Br. at 5). APS believes that FERC considers and pays deference to state commission views on the acquisition of generating assets (Tr. at 63, 64).

APS states that it was not disputed in this proceeding that this Commission's "approval" of the transaction would help APS and PPL Sundance obtain such approval from FERC (APS Reply Br. at 2). PPL Sundance states, however, that the FERC approval process for the Sundance Plant acquisition may not resemble the proceedings that APS referred to in which FERC has placed value

on state commission support (Tr. at 32, 33). PPL Sundance believes that the open bidding process that preceded this acquisition, which did not include APS affiliate participation, differentiates this case from others at FERC in which affected power producers have complained about the effect of acquisitions on purchasers' generation market power (*Id.*).

At the time of the hearing, APS had not yet made a filing at FERC requesting approval (*see* Tr. at 122). The record in this proceeding does not include an evaluation of the factors that FERC normally considers in a Section 203 approval proceeding (Tr. at 121-123). This Commission's deliberations in this proceeding are not on point relative to the upcoming FERC approval process (Tr. at 30, 31). We do not believe, therefore, that our determination in this Decision that pre-approval of the acquisition is inappropriate and not in the public interest (due to ratemaking considerations) will be relevant to FERC's disposition of the APS and PPL Sundance application for Section 203 approval. In addition, we strongly disagree with the view expressed by PPL Sundance on brief that "mere tacit acquiescence or concurrent 'non-action' by [this] Commission could be seen to signal some concession to FERC of sole jurisdiction or interest" (*See* PPL Sundance Br. at 11). This Decision is based on the facts on the record in this proceeding, which are distinct and apart from the Section 203 approval process at FERC.

II. Prudence and Used and Useful Determination

A. Arguments

The Joint Application requested a determination that the acquisition is prudent and that the plant is used and useful. APS argues that this Commission's definition of "prudently invested"[7] sets forth no requirement that prudence findings are only to be made during a rate case. While conceding that typically it has been only during a rate case that such a finding was necessary, or that the necessary information became available, APS argues that the most appropriate time to make a prudence determination, when possible, is at the time a resource is acquired (APS Br. at 9). APS contends that if circumstances permit such timing, a contemporaneous prudence determination is

[7] A.A.C. R14-2-103(A)(3)(l) provides: "1. 'Prudently invested' – Investments which under ordinary circumstances would be deemed reasonable and not dishonest or obviously wasteful. All investments shall be presumed to have been prudently made, and such presumptions may be set aside only by clear and convincing evidence that such investments were imprudent, when viewed in the light of all relevant conditions known or which in the exercise of reasonable judgment should have been known, at the time such investments were made."

more consistent with the prudence standard of "at the time such investments were made" than a *post hoc* determination (APS Reply Br. at 4, 5). APS states that it has responded to all of Staff's requests for information pertaining to the acquisition, and argues that because investments are presumptively prudent under Commission rules, the burden is on an opposing party to show by clear and convincing evidence that an investment is imprudent (APS Br. at 9, 10).

APS' witness asserts that the Sundance Plant meets the conventional test for a "used and useful" determination, which he describes as whether there is a functional need for an asset, and whether the asset has actually been employed to meet the need (Exh. APS-1 at 16). He states that when acquired by APS, the Sundance Plant will be effectively integrated into APS' dispatch system and will be immediately used and useful in the day-to-day operation of APS' system (*Id.*).

RUCO points out that the purpose clause of the rule defining "Prudently invested," found in A.A.C. R14-2-103, states that the purpose of Rule 103 is to define the specific information required to make determinations within a rate case such as prudence (RUCO Reply Br. at 4). RUCO states that while it has not taken a position on whether the acquisition is prudent, neither RUCO nor any other party should be required to make such a recommendation outside of a rate case (*Id.* at 4, 5).

Staff disagrees with APS' assertion regarding the current availability of all the information necessary to determine rate base treatment of the acquisition for two separate reasons (Staff Br. at 4, 5). Staff first contends that APS is unable at this time to precisely quantify the purchase price (Staff Br. at 4), and second, that APS cannot demonstrate at this time the prudence of a $4.5 million portion of the purchase price attributable to an extension of the transaction's closing date to accommodate the application for FERC approval (Staff Br. at 5).

Staff explains that the stated $189.5 million purchase price could increase by as much as $3 million, depending upon PPL Sundance's exercise of an option in the Asset Purchase Agreement that allows PPL Sundance to extend the closing date of the transaction for sixty days at a cost to APS of $50,000 per day (*see* Exhibit A attached hereto at Section 3.1 and Section 10.1(g)), because if PPL Sundance exercises this option, APS intends to include the additional amount in the rate base value of the Sundance Plant (*see* Tr. at 104; Staff Br. at 4-5). Staff states that APS has additionally agreed to pay an additional $4.5 million to extend the transaction's closing date to March 31, 2005, because the

extension was necessary to accommodate its application for FERC approval (Tr. at 105-106). Staff argues that while the record clearly shows that extending the closing date added $4.5 million to the purchase price, the record did not establish that it would be impossible to obtain FERC approval prior to March 31, 2005 (Staff Br. at 5). Staff contends that it would be difficult at this time to evaluate the reasonableness of APS' efforts at FERC when its application has not yet been filed, noting that it is difficult to evaluate the prudence of actions that have not yet occurred (*Id.*).

APS argues that the lack of completeness of the record in this proceeding regarding the final purchase price and the additional $4.5 million payment for an extension of time to allow for FERC approval would not actually interfere with this Commission's ability to appropriately determine the rate basing of the Sundance Plant in this proceeding (APS Reply Br. at 3). APS suggests that the $189.5 million purchase price could be "approved," and that any additions to that amount which that may result from the application of Section 3.1 and Section 10.1(g) of the Asset Purchase Agreement could be considered in a future rate case. Regarding the additional $4.5 million in the purchase price resulting from an extension of time to allow for the FERC approval process, APS states that while no party presented any evidence that the applicants should have handled the FERC application any differently, this amount could also be "reserved . . . for future consideration in a rate case while still providing a prudence determination on the vast majority of the plant in question" (APS Reply Br. at 4).

B. Analysis and Conclusion

The A.A.C. R14-2-103(A)(3)(l) definition of "prudently invested" both follows and refers to the term "prudently invested" as it appears in the rules' definition of "Original cost rate base" in A.A.C. R14-2-103(A)(3)(h).[8] The term "prudently invested," which appears nowhere else in Rule 103, clearly applies to "Original cost rate base" determinations, which are determined in a rate proceeding. As the definition of "Original cost rate base" reveals, rate base determinations are complex, based as they are on a number of factors related to the historical test year. None of those factors have been quantified on the record at this time for APS' next rate case.

[8] "h. "Original cost rate base" – An amount consisting of the depreciated original cost, prudently invested, of the property (exclusive of contributions and/or advances in aid of construction) at the end of the test year, used or useful, plus a proper allowance for working capital and including all applicable pro forma adjustments." A.A.C. R14-2-103(A)(3)(h).

While it may be true, as APS argues, that there is no rule or statute that precludes this Commission from determining prudence or precluding a utility from seeking such a determination at the time an acquisition is made (APS Reply Br. at 4), Rule 103's definition of "prudently invested" is clearly backward-looking. The language of the rule does not contemplate a determination of prudence prior to the occurrence of investment. It provides for a backward look at prudence, stating that "[a]ll investments shall be presumed to have been prudently made, and such presumptions may be set aside only by clear and convincing evidence that such investments were imprudent, when viewed in the light of all relevant conditions known or which in the exercise of reasonable judgment should have been known, at the time such investments were made." (A.A.C. R14-2-103(A)(3)(l)(emphasis on past tenses added)).

More importantly, while A.A.C. R14-2-103(A)(3)(l) presumes prudence of investments, it provides that the presumption may be set aside by clear and convincing evidence. Because the transaction has not yet been completed, no party has had the opportunity to challenge the presumptive prudence of the actual investment. While the actual purchase price, when determined, may be reasonable, and while APS' decision to pay an additional $4.5 million for the Sundance Plant to extend the closing date to accommodate the required FERC approval process may be reasonable, it would be against the public interest at this time for this Commission to make a determination on the prudence of the acquisition outside a ratemaking proceeding, without all the facts about the transaction being available and subject to evidentiary review. APS' suggestion that the final adjustments to the purchase price and the $4.5 million portion of the purchase price attributable to the delay required for FERC approval could be scrutinized in a future rate proceeding, apart from a general determination of prudence of the acquisition, amounts to an admission that all the evidence surrounding the acquisition is not yet available. APS' suggested bifurcation approach must be rejected, because the overall transaction may only properly be reviewed in the context of an overall rate base determination, with all relevant information available.

For these reasons, as well as for the reasons discussed above in the analysis of the request for "approval" of the transaction, we find that it would be speculative, and therefore improper, to make either a full or partial determination at this time whether APS will have "prudently invested" in assets

which it has yet to acquire.

III. Future Ratemaking Treatment

The Joint Application requested confirmation that the Sundance Plant will be afforded traditional cost of service treatment in the future.

A. Arguments

APS believes that the record in this case supports providing clarification that the Sundance Plant will be afforded traditional cost-of service regulation, and that such clarification can be made regardless of the conclusion reached on APS' request for a prudence and used and useful determination at this time (APS Br. at 8). APS states that its request for clarification of the Sundance Plant's future ratemaking treatment is similar to its request for approval of the transaction (APS Br. at 7).

RUCO supports APS' request for clarification of the alleged regulatory uncertainty regarding APS' authority to acquire new generating assets, but contends that ratemaking treatment should not be pre-approved in this proceeding (RUCO Br. at 4). RUCO argues that this is not an emergency filing (*see* Tr. at 247), that an emergency situation does not exist, and that the circumstances of this case do not justify deviation from the policy of considering acquisition costs and operating expenses in the context of a rate case (RUCO Br. at 3, 4). RUCO recommends Commission confirmation that APS' acquisition of the Sundance Plant would be subject to traditional cost of service regulation if it is found to be a prudent acquisition and used and useful in APS' next rate case (Direct Testimony of Marylee Diaz-Cortez, Exh. RUCO-1 at 10). Staff's witness testified that Staff does not believe the confirmation recommended by RUCO is necessary, but does not oppose RUCO's recommendation (Tr. at 355). Staff argues, however, that no factors exist in this proceeding that provide a compelling reason to determine the ratebase treatment for the Sundance Plant outside a rate case (Staff Reply Br. at 2). Staff further argues that even if unique or novel circumstances were to exist, mere novelty does not justify premature rate case relief, and that the existence of novel circumstances would call for review in a rate case, rather than justify departure from usual ratemaking procedures as requested by APS (*Id.*).

B. Analysis and Conclusion

As APS is well aware, when in the context of a ratemaking proceeding a public service corporation requests rate relief for assets not previously accorded rate base treatment, the request is considered under traditional cost of service ratemaking principles, which include examination and evaluation of all rate base issues in the context of the public service corporation's total operations. This is not a rate proceeding, there was no request to consolidate the Joint Application with the pending rate proceeding, and the acquisition has yet to occur. Because we cannot speculate now as to whether unusual circumstances may or may not occur or may or may not be associated with APS' potential acquisition of the Sundance Plant prior to APS' next rate proceeding, it would be premature to determine at this time that the Sundance Plant acquisition will satisfy the evidentiary and legal standards necessary to be accorded full cost recovery under traditional cost of service principles in that future rate proceeding. However, if APS requests rate relief for the Sundance Plant in the context of a ratemaking proceeding, the request will be considered under traditional cost of service ratemaking principles, which include examination and evaluation of all rate base issues in the context of APS' total operations.

IV. Existing Financing Authority for the Transaction

The Joint Application requested confirmation that APS' existing financing authority can be used to finance the acquisition of the Sundance Plant. APS asserts that as long as the prior Commission Orders in Decision No. 54230 (November 8, 1984) and Decision No. 55017 (May 6, 1986) apply, APS has sufficient long-term debt authorization outstanding to finance the acquisition, and requests that this Decision include a Finding of Fact and Conclusion of Law so confirming (APS Br. at 8, 9). PPL Sundance believes that APS' existing financing authority would cover financing of the Sundance Plant acquisition (PPL Sundance Br. at 10).

Staff states that Decision Nos. 54230 and 55017 allow APS to issue long-term debt up to approximately $2,699 million (Exh. S-3 at 14). Staff explains that while APS' total long-term debt (including current maturities) as of June 30, 2004 was $2,717 million, Commission Decision No. 65796 (April 4, 2003) allowed APS to borrow $500 million that would not be classified as continuing debt in the context of the debt limits established in Decision Nos. 55017 and 54230 (Exh. S-3 at 14,

citing Decision No. 65796 at 41, lines 16-17). Staff states that the total debt that is subject to APS' existing financing authority is therefore $2,717 million minus $500 million, or $2,217 million (Exh. S-3 at 14). Staff states that this leaves APS with $482 million of existing financing authority *(Id.)*.

Decision No. 54230 authorized APS to issue debt, subject to A.R.S. § 40-301, for a variety of purposes, among them "to finance [APS'] construction program, to redeem or retire outstanding securities, to repay or refund other outstanding long-term debt, to repay short-term debt which previously financed construction projects . . . ." Decision No. 55017 approved debt issuance for the same purposes, and also authorized financing for the purpose "if necessary, to meet certain working capital and other cash requirements . . . ." No party objected to confirmation of APS' financing authority under these prior Decisions. While it is not necessary, it is not unreasonable to grant APS' request to include a Finding of Fact and Conclusion of Law in this Decision confirming that the authorizations previously granted in Decision No. 54320 and Decision No. 55017 apply to this transaction, and such confirmation will be given.

V. Accounting Deferral Order

The Joint Application requested a deferred accounting order authorizing APS to defer for future recovery a portion of the capital and operating costs associated with the acquisition of Sundance, net of cost savings to APS from the acquired assets. An accounting order is a ratemaking mechanism that provides regulated utilities the ability to defer costs that would otherwise be expensed using generally accepted accounting principles (Direct Testimony of Staff witness Jamie R. Moe, Exh. S-1 at 2). It also permits alternative accounting treatment for capital and other costs as permitted under the Uniform System of Accounts (*Id.*).

A. Initial Proposals on Accounting Deferral Request

The direct testimony of APS witness Patrick Dinkel, admitted to the record as hearing Exhibit APS-4, included Schedule PD-4 as an attachment. Schedule PD-4 included the following specific Ordering Paragraphs proposed by APS:

> IT IS THEREFORE ORDERED that Arizona Public Service Company's request for an accounting/rate-making Order permitting it to defer and capitalize, for later recovery through rates, the costs, net of any savings, of owning, operating, and maintaining the Sundance Generating

Station and associated facilities be, and hereby is granted.

IT IS FURTHER ORDERED that Arizona Public Service Company shall be allowed to defer a return on all of the deferred costs computed using its embedded cost of long-term debt as determined by the Commission in Docket No. E-01345A-03-0437 or if no such cost of debt is determined in that Docket, then the embedded cost of debt as of December 31, 2004 as prescribed by Schedule D-2 of A.A.C. R14-2-103.

IT IS FURTHER ORDERED that Arizona Public Service Company's authority to defer costs is limited to five years from the date of a final Commission order in this case.

IT IS FURTHER ORDERED that the regulatory asset associated with all amounts deferred pursuant to this Decision shall be included in cost of service for rate-making purposes in Arizona Public Service Company's next rate case as will the amortization of such regulatory asset.

Staff's direct testimony included a recommendation that the following 11 conditions apply to an accounting deferral order (Exh. S-1 at 14-15):

1) No deferrals shall be recorded unless a PSA is adopted in its pending rate case that recognizes off-system sales as a credit (reduction) to the recoverable balance.

2) The deferral period shall not begin until the PSA becomes effective.

3) Debits (additions) to the deferred costs shall be made only in the months that the PSA remains in effect.

4) Debits to the deferred costs shall terminate no later than 36 months after the date of the order in this case.

5) Debits to the deferred costs shall terminate on the effective date of rates authorized in any rate case subsequent to the pending rate case.

6) No cost of money factor shall be applied to any deferred amounts.

7) Overhead costs shall not be deferred.

8) Deferred direct costs shall only be debited when supported by an analysis conducted by the Company demonstrating that those costs have not been otherwise recovered.

9) Projections may be used to calculate the net savings components (fuel costs, purchased power and off-system sales) of deferred

costs. The projections shall have identical parameters, except to recognize the inclusion of the Sundance Generation Station, to eliminate bias and manipulation and to facilitate accurate measurement of net savings.

10) The results of the projections shall be reported as part of the monthly filings required for the PSA.

11) APS shall participate in the net savings/costs related to fuel and purchased power costs and off-system sales at the same percentage rate as it participates in the PSA.

B. Post-Hearing Filings on Accounting Deferral

During the hearing, Staff stated that APS and Staff were anticipating ongoing discussions regarding both the operation of Staff's proposed Condition No. 8 and APS' proposed accounting order language. At the close of the hearing, it was agreed that either APS, or APS jointly with Staff, would file a late-filed exhibit on October 12, 2004, regarding both 1) accounting order language and 2) the operation of Staff's recommended Condition No. 8. It was also agreed that all parties would file any comments on the October 12, 2004 filing by October 19, 2004.

On October 12, 2004, APS filed a Notice of Submission of Late-Filed Exhibit. APS' filing includes a Revised Schedule PD-4 which reflects its proposal for 1) specific ordering language that APS believes necessary to allow the deferral to be booked to APS' balance sheet under the criteria of Statement of Financial Accounting Standards No. 71 ("FAS 71"); 2) additional language APS proposes be added to Staff's recommended Condition No. 8; and 3) additional language APS proposes be added to Staff's recommended Condition No. 11. APS' Revised Schedule PD-4 is attached to this Decision as Exhibit B, and includes both a clean copy and a redline copy showing changes to APS' original Schedule PD-4, as attached to hearing Exhibit APS-4.

On October 19, 2004, Staff filed a Notice of Filing Staff's Response to APS' Late-Filed Exhibit. Staff's response is in the form of a Staff Report responding to APS' October 12, 2004 filing. Attached to the Staff Report are three Exhibits, as follows: 1) "Exhibit 1," Explanation of Staff's Condition No. 8; 2) "Exhibit 2," which includes Staff's proposed Addendum to Staff Condition No. 8 and Staff's proposed Addendum to Staff Condition No. 11; and 3) "Exhibit 3," which reflects Staff's recommendation for specific ordering language for an accounting order. Those Staff Report Exhibits

1 through 3 are attached to this Decision as Exhibit C.

C. Deferral Order Request

1. Proposed Methodology for Calculation of Deferral

APS requests authority to defer for future recovery all capital and operating costs associated with the acquisition, with a debt return, net of any savings produced by the acquisition (Joint Application at 12). APS proposes that the savings resulting from the purchase of the Sundance Plant, such as reduced fuel costs and reduced purchased power costs (including APS' Track B Contract with PPL Sundance) would reduce the amount of deferrals associated with capital and operating costs each year (Exh. APS-4 at 19-20). APS also proposes that to avoid double-counting such savings, all fuel cost savings, purchase power cost savings, and additional off-system sales margins[9] would be excluded from the calculation of recoverable fuel and purchased power costs in the power supply adjustor ("PSA")[10] that APS is requesting in its pending rate case (Exh. APS-4 at 19-20).

APS proposes to calculate the net fuel cost savings, purchased power savings, and incremental off-system sales margin impacts by comparing two sets of projections for its own load fuel and purchased power costs and off-system sales margins and using the difference as the net savings amounts (*See* reproduction of APS' response to Staff's data request in Exh. S-1 at 4). One set of projections would be made assuming APS ownership of the Sundance Plant, and one set of projections would be made assuming no APS ownership of the Sundance Plant) (*Id.*). APS states that a detailed hourly simulation of its off-system sales would be the main point of comparison, but the comparison would also include any changes to fixed costs, such as natural gas transportation and wheeling charges, that might be present in one situation but not the other (*Id.*). Based on the results obtained in these analyses, APS proposes to adjust for the PSA the actual fuel and purchase power costs, net of off-system sales revenues, to calculate the PSA balance as if the Sundance acquisition did not occur. APS believes this is consistent with the approach of deferring all other costs related to the Sundance Plant acquisition as if they did not occur. APS states that the result of the proposed

[9] Off-system sales margins are generally the revenues from off-system sales minus the costs associated with producing those revenues (Tr. at 200, 201).

[10] A general discussion of how the proposed PSA operates appears in the Rebuttal Testimony of Peter Ewen (at pages 4-18) and the Rebuttal Testimony of Donald G. Robinson (at pages 11-20) filed in the pending APS rate case Docket No. E-01345A-03-0437.

deferral, along with the equal and offsetting adjustment to the PSA, would be that customers would receive the benefit of the savings associated with the fuel and purchase power cost savings and net off-system sales revenues as a reduction to the cost deferrals associated with the Sundance Plant acquisition (*Id.*).

2. Arguments

APS, PPL Sundance, AUIA and Sempra/Southwestern believe that a deferral accounting order should be granted regardless of whether the proposed PSA is approved in APS' pending rate case. RUCO opposes approval of the accounting deferral order request, whether the PSA is approved or not. Staff recommends that an accounting order be issued authorizing APS to defer costs associated with the purchase of the Sundance Plant only if the PSA that recognizes off-system sales margins as a credit (reduction) to the recoverable PSA balance, as proposed by the settlement agreement in APS' pending rate case, is approved.

APS contends that it was able to obtain a very favorable price for the Sundance Plant, but that the acquisition will result in an adverse financial impact to APS because the costs associated with the new investment will not yet be reflected in APS' rates, and that the financial impact should be mitigated by means of its proposed cost deferral accounting order (Exh. APS-4 at 18). APS' witness testified that the Sundance Plants' units, which are more efficient with their lower heat rates, and therefore less costly to run, would displace less-efficient units in APS' dispatch order, such that APS would save money on an incremental basis, and save wear and tear on the less-efficient units, making them available down the road for installed reserves or other emergency purposes (Exh. APS-1 at 8; Tr. at 108, 109). APS claims that the long-term savings resulting from APS' purchase come at a short-term cost that, without a deferral order, would be borne solely by APS shareholders with no opportunity to recover such costs (APS Br. at 12). APS argues that a "mismatch of costs and benefits" would be amplified by the operation of the proposed PSA in its pending rate case, because the acquisition will result in lower overall fuel and purchased power costs for APS (APS Br. at 12-13), but that a mismatch will occur regardless of whether a PSA is in place (*Id.* at 14). PPL Sundance is in agreement with APS' position regarding a deferral accounting order, and supports Commission adoption of such terms as APS suggests (PPL Sundance Br. at 12).

AUIA believes that approval of an accounting deferral is an absolute requisite to allowing the transaction to go forward (Exh. AUIA-1 at 2, 7-8). AUIA argues that it would be unfair for APS' shareholders to be required to absorb APS' estimate of $10 to $15 million per year prior to rate-basing the Sundance Plant, in the absence of an accounting deferral (AUIA Br. at 5), and that the deferral must meet the requirements of FAS 71 in order to serve a useful purpose (AUIA Br. at 8). AUIA believes it is unnecessary to make the accounting order dependent on a PSA, but does not oppose this condition, because according to AUIA, it is unlikely that APS can complete the transaction in the absence of a PSA (AUIA Br. at 6).

RUCO states that the costs APS will incur and the benefit to ratepayers as a result of the acquisition occur in every transaction where a utility purchases assets (RUCO Reply Br. at 2-3). RUCO believes that an accounting order would skew the normal operation of regulatory lag, which is the timing difference between the time a given cost is incurred and the time the cost is recovered, and that APS' shareholders would unfairly benefit from it (Exh. RUCO-1 at 6 -7). RUCO explains that typically, when a company acquires new plant, it does not begin to earn a return on that plant and its associated costs until new rates go into effect, and that this phenomenon is typically offset by the fact that the plant and its associated costs continue to earn a return, and recover depreciation, after it is retired until new rates are set after the retirement has occurred (*Id.* at 6, 7). RUCO contends that it is generally accepted in the regulatory world that the regulatory lag and accompanying under-recovery that occurs prior to the plant's first inclusion in rate base and the regulatory lag and accompanying over-recovery that occurs after the plant's actual retirement from service are offsetting, or self-correcting, over time and that an adjustment is not necessary (*Id.* at 7).

APS and PPL Sundance argue that RUCO fails to recognize a mismatch in revenues received from customers and the costs incurred by APS to deliver service using the Sundance Plant (APS Br. at 13; PPL Sundance Br. at 11). RUCO argues that it does recognize a "mismatch," in that the requested deferral considers only a select group of costs and revenues associated with the acquisition, and excludes others, such as assets retired during the deferral period, and all other rate case elements associated with a rate case (RUCO Reply Br. at 2-3).

Like RUCO, Staff contends that addition of plant and incurrence of its associated costs

between rate cases is a frequent and normal event, and that such events that occur outside a test year, including load growth and additional sales, are normally offsetting and provide benefits as well as detriments to a utility (Exh. S-1 at 6). Staff states that the lack of recognition of Sundance Plant-related capital and operating and maintenance costs in APS' pending rate case is not a sufficient reason to justify cost deferral and that generally, it would not recommend that a deferral account be authorized for the recovery of costs related to plant additions that occur between rate cases (*Id.*). Staff's position differs from that of RUCO, however, in that Staff believes that the operation of the PSA, if it is approved in APS' pending rate case, would create a potential inequity to APS for purchasing incremental generating capacity between rate cases (*Id.* at 7). Staff believes that the inequity that would result from the combination of the timing of the acquisition and the proposed PSA could be remedied by the creation of a deferral account, which would enable APS to recover certain capital and operating costs associated with the Sundance Plant (Exh. S-1 at 7).

3. Analysis and Conclusion

We agree with RUCO and Staff that under normal circumstances, APS' proposal for an accounting order would allow APS shareholders to reap the positive benefit of regulatory lag without the offsetting negative regulatory lag effects of plant acquisition between rate cases. The "mismatch of costs and benefits" that APS claims provides justification for a deferral order in the absence of the proposed PSA is simply regulatory lag, which is, as Staff and RUCO argue, a timing difference inherent to the regulatory process. The negative regulatory lag resulting from the time between a utility's investment and the time the costs are included in rate base is typically offset by the positive regulatory lag resulting from the fact that the plant and its associated costs continue to earn a return, and recover depreciation, after retirement of the plant and prior to its removal from rate base.

The accounting order issued in Decision No. 55939 (April 6, 1986)(Palo Verde III Deferral Case) does not provide precedent for an accounting deferral order here, as APS contends (*see* Exh. APS-4 at 19; APS Br. at 12, 13; APS Reply Br. at 10-11, citing Decision No. 55939 at 3). This case is distinguishable. As RUCO points out (RUCO Br. at 8), in the case of the Palo Verde III deferral, APS was involved in a lengthy process of plant construction with costs in the billions of dollars. Approval of that deferral was based on the Commission's wish not to risk APS' investment grade

bond ratings, because the increased capital costs associated with such a downgrade would have placed a far greater and more immediate financial burden on ratepayers than the consequences of the approved deferral (Decision No. 55939 at 5). Here, as RUCO argues, APS is not building plant, but purchasing operational plant that represents a small fraction of APS' total plant. We note also that the rates proposed in the settlement agreement in APS' pending rate case already include a portion of the costs of the Sundance Plant currently used by APS via the inclusion of a purchased capacity contract between APS and PPL Sundance (Tr. at 209).

APS argues that it could lose $60 million on a present value basis without a deferral order (*See* APS Br. at 13, citing Exh. APS-5 at Schedule PD-1RB), and PPL Sundance posits that denial of a deferral could result, in the long run, in APS filing multiple, frequent rate cases in order to mitigate APS' estimated cost inequities resulting from regulatory lag (PPL Sundance Br. at 11). Our consideration of the requested accounting deferral in this case is not based on any conjecture regarding APS' future rate case filings. As RUCO has pointed out, it is always a utility's prerogative to file a rate case application when it deems it appropriate (RUCO Reply Br. at 4). We would expect APS to make a reasonable business decision regarding the need to make a rate filing.

On brief, RUCO asserts that because the PSA is under Commission consideration in the settlement agreement docketed in APS' pending rate case, and because the parties to the settlement agreement did not address or consider the deferral order request, approval of APS' proposal in this case would amount to altering the terms of the docketed settlement agreement (RUCO Br. at 6, 7). Staff responds that RUCO fails to explain how the deferral mechanism would change the proposed terms of the settlement agreement (Staff Reply Br. at 8). Staff states it is difficult to see how the treatment of the post-test year events with which the Joint Application is concerned can change the terms of the settlement agreement (*Id.*). APS states that the deferral request in this case, which includes an offset to the PSA balance in order to avoid double-counting savings in the PSA, does not change the proposed PSA, but simply results in a mechanism that overlays the proposed PSA (APS Reply Br. at 12). We agree with APS that the deferral request and its accompanying proposed offset to the PSA would not change the terms of the proposed PSA in the pending APS rate proceeding.

RUCO believes that APS' request for an accounting order amounts to a request for special

ratemaking treatment where no special circumstances exist, and that an accounting order would result in single-issue ratemaking (RUCO Br. at 5, 6). RUCO argues that APS' proposed calculation of net savings that would result from the purchase of the Sundance Plant is speculative, subject to manipulation, and that its accuracy would be difficult to confirm (RUCO Br. at 6), and asserts that this Commission will not be able to consider all the other ratemaking elements that were affected by the transaction during the deferral period (RUCO Reply Br. at 3). APS argues, however, that the use of projections is a proven, verifiable and well-established method that is routinely used in rate cases and other proceedings involving resource procurement issues (APS Reply Br. at 10). APS contends that a deferral would not constitute single issue ratemaking because no existing rates would be changed as a result of the Commission granting a deferral in this case (APS Br. at 14), but that rates would only be changed in a subsequent rate case, when the deferred costs are considered along with all other appropriate factors, costs, and benefits (*Id.*). As explained below, we find that special circumstances will exist in this case if the PSA is approved in APS' pending rate case. We also agree with APS that because rates would not be changed as a result of an accounting deferral order, that it would not constitute single-issue ratemaking, and that a deferral order would not presume to determine new rates (*See* APS Reply Br. at 11).

Sempra/Southwestern urges approval of the requested accounting deferral irrespective of whether the PSA is approved in APS' pending rate case, "given the fact that future proposed acquisitions of IPP- or merchant generator-owned generation assets by a public service corporation may not arise against the background of a currently pending rate case and proposed PSA of the nature here in question" (Sempra/Southwestern Reply Br. at 8). Sempra/Southwestern believes that an accounting order may provide the assurance of future rate recovery that may be necessary to allow a utility to compete with unregulated entities for generation asset acquisitions (*Id.*). Sempra/Southwestern's arguments appear to emanate from an interest in making the future purchase of merchant generator-owned generation assets more attractive to regulated utilities, and do not provide a convincing rationale for approving a deferral in this case in the absence of the existence of the proposed PSA in APS' pending rate case. As further explained below, this Decision is based on the facts of this case, and does not speculate on the possibility of any "future proposed acquisitions"

as referenced by Sempra/Southwestern.

In support of its position that a deferral should be approved in the absence of a PSA, PPL Sundance points out that pursuant to Paragraph 8.7(b) of the Asset Purchase Agreement, APS can walk away from the acquisition if all the approvals requested in the joint application are not approved (PPL Sundance Reply Br. at 3-4). For the reasons discussed below in Section VII(A), we do not find this argument a convincing reason to approve a deferral accounting order in the absence of the PSA as proposed in APS' pending rate case.

We agree with Staff, however, that the operation of the proposed PSA's cost/savings sharing component, if approved in APS' pending rate case, coupled with the timing of the acquisition in relation to the pending rate case, could create a potential for inequity that justifies the creation of a deferral in this case. The PSA in the proposed settlement agreement includes three components that affect the PSA balance: fuel costs, purchased power costs, and off-system sales margins (Exh. S-1 at 5). As set forth in the settlement agreement in the pending APS rate case, the PSA includes an incentive mechanism where APS and its customers share in fuel and purchased power costs or savings at a rate of 90 percent for customers and 10 percent for APS.[11] The proposed PSA provides that ratepayers will also receive the benefits of all off-system sales margins through a credit to the PSA balance at the 90 percent/10 percent sharing rate. Off-system sales margins are generally the revenues from off-system sales minus the costs associated with producing those revenues (Tr. at 200, 201). APS' acquisition of the Sundance Plant would increase APS' capacity for off-system sales because it would increase APS' overall generating capacity (*Id.* at 7), but because of the operation of the proposed PSA, APS would be able to keep only 10 percent of the off-system sales margins (Tr. at 211). Thus, even though APS would incur capital and operating costs related to the Sundance Plant that would allow increased off-system sales, APS' ability to recover those costs from increased off-system sales margin revenues would be limited by the operation of the PSA. In addition, under the proposed PSA, 90 percent of any fuel savings costs resulting from the Sundance Plant's lower costs would be passed through to customers (Tr. at 238). Accordingly, under the specific circumstances of

[11] *See* Section IV, Paragraph 19 of the proposed settlement agreement filed in Docket No. E-01345A-03-0437 on August 18, 2004.

this case, we believe it is equitable to approve the requested accounting deferral, subject to the condition that the PSA as set forth in the settlement agreement in APS' pending rate case is approved, and subject to additional conditions as discussed herein in Section V.

D. Staff's Proposed Conditions

1. Staff's Proposed Condition No. 1 - No Deferral Absent Approval of the PSA in the Pending Rate Case

Staff recommends that an accounting deferral order be granted, subject to the following Condition No. 1:

1. No deferrals shall be recorded unless a PSA is adopted in its pending rate case that recognizes off-system sales as a credit (reduction) to the recoverable balance.

For the reasons articulated above, this condition is reasonable and will be adopted.

2. Staff's Proposed Condition No. 2 - Deferral Period Begins With PSA Effective Date

Staff recommends that an accounting deferral order be granted subject to the following Condition No. 2:

2. The deferral period shall not begin until the PSA becomes effective.

For the reasons articulated above, this condition is reasonable and will be adopted.

3. Staff's Proposed Condition No. 3 - Duration of Deferrals Coincident with Duration of PSA

Staff recommended that an accounting deferral order be granted subject to the following Condition No. 3:

3. Debits (additions) to the deferred costs shall be made only in the months that the PSA remains in effect.

For the reasons articulated above, this condition is reasonable and will be adopted.

4. Staff's Proposed Condition No. 4 - Termination of Deferrals After 36 Months

Staff recommended in its direct testimony that an accounting deferral order be granted subject

to the following Condition No. 4:

> 4. Debits to the deferred costs shall terminate no later than 36 months after the date of the order in this case.

In its October 19, 2004 post-hearing filing, Staff proposed a change to this condition, in the form of a proposed Ordering Paragraph (*See* "Exhibit 3" of Exhibit C attached hereto), which would have the effect of changing Staff's proposed Condition No. 4 to require that debits to the deferred costs shall terminate no later than 36 months after the later of the date that APS acquires the Sundance Generating Station or the new rates go into effect and only if the PSA in the APS rate case is adopted. Staff believes that the date of this Decision may not be the appropriate time to start the 36 month period, as this Decision may become effective prior to the acquisition (October 19, 2004 post-hearing Staff Report at 4).

APS agrees with Staff that the appropriate time to start the deferral period is the later of the date that APS acquires the Sundance Plant or the date new rates go into effect, rather than the date of this Decision (APS Br. at 15). APS disagrees, however, with the 36 month deferral period that this proposed condition would require.

APS contends that a five year, or 60-month, deferral period is warranted in this case, because the 36 month period suggested by Staff would effectively require APS to consider filing a new rate case within the next year or so to be assured of rate case completion within the deferral period, so that the costs would be reflected in rates as soon as the deferral period ends (APS Reply Br. at 7). APS claims that not having the costs of the Sundance Plant reflected in rates immediately following the end of the deferral period would result in "the inequity of APS shareholders bearing costs that benefit customers (in both the short term and long term) with no opportunity to recover those costs" (APS Br. at 15). APS argues in support of its proposed 60 month deferral period that Staff's proposed Condition No. 8, if adopted, would mitigate any concerns of intergenerational inequity resulting from

the longer deferral period (APS Br. at 15).

Staff contends that conceptually, a deferral shifts costs from one time period to another (Tr. at 255), and as a result, the ratepayers for whom costs are incurred may not be the same ratepayers who ultimately pay them (Exh. S-1 at 11), and that a longer deferral period exacerbates these intergenerational inequities (*Id.*; Tr. at 170-171). Staff believes that three years is an appropriate amount of time for APS to record and assess the costs of the Sundance Plant; assess its recovery of the costs; take six months to prepare and file a rate case; and complete a rate case (Tr. at 170). Staff takes issue with APS' testimony (*See* Exh. APS-5 at 4) that it would take longer than the 12 month period required by Commission rules to complete a rate case, pointing out that the currently pending rate case, which has been the subject of settlement negotiations involving more than twenty parties, is not typical of Commission rate proceedings (Staff Reply Br. at 6-7). Staff also points out that APS can file a request for an extension of the deferral period (*Id.;* Exh. S-1 at 11).

While we find it reasonable, in conjunction with the operation of the proposed PSA, if approved, to allow APS to defer costs not otherwise recovered, we do not wish to encourage APS to unnecessarily postpone ratemaking review of the acquisition by allowing deferrals to continue for a five-year period. Because actual recovery of deferred costs can only commence after a rate proceeding, we find Staff's arguments regarding intergenerational inequity convincing. Three years is a reasonable timeframe to allow APS to defer costs associated with the acquisition of the Sundance Plant that have not already been recovered, in the event the proposed PSA is approved in APS' pending rate case. As we have already noted, if APS wishes the costs of the Sundance Plant to be reflected in its rates sooner, it need not wait to file a rate case. However, given that rate cases in general may take longer to complete than the period prescribed in the Commission's rules, we agree that it is reasonable to amend this condition to provide that if APS has a general rate case pending at the end of the 36-month period, APS may continue to defer costs associated with the acquisition of

the Sundance Plant until such rate case is concluded. APS' next rate case shall address the deferred amounts recorded as of ninety days before the due date for filing Staff's Direct Testimony. Any additional properly deferred amounts recorded after that date may be considered in subsequent rate case(s).

5. Staff's Proposed Condition No. 5 - Termination of Deferrals on Effective Date of New Rates from Next Rate Case

Staff recommended that an accounting deferral order be granted subject to the following Condition No. 5:

> 5. Debits to the deferred costs shall terminate on the effective date of rates authorized in any rate case subsequent to the pending rate case.

APS agrees with this condition (APS Br. at 15). It is reasonable and will be adopted.

6. Staff's Proposed Condition No. 6 - No Application of Cost of Money Factor to Deferral

Staff recommended that an accounting deferral order be granted subject to the following Condition No. 6:

> 6. No cost of money factor shall be applied to any deferred amounts.

APS argues that the carrying costs associated with the acquisition are real costs, and that a cost of money is applied to other assets in similar circumstances, such as when a utility is allowed to capitalize substantial amounts of construction carrying costs for self-built plants as Allowances for Funds Used During Construction ("AFUDC") (APS Br. at 16).

Staff argues that because the net savings will be estimated by models, the exact amount of savings to be netted against the costs is unknown, and that although the deferral balance itself will represent a reasonable estimate of the costs attributable to the Sundance Plant, the imprecise nature of the deferred costs makes it inappropriate to include a return (Exh. S-1 at 12). Staff believes that calculating a return on the imprecise amounts will exacerbate the intergenerational inequities

resulting from the deferral (Exh. S-1 at 12-13).[12]

APS argues that greater uncertainty exists regarding total costs when a rate of return is permitted on AFUDC than exists in this case (APS Reply Br. at 7). Staff asserts, however, that the imprecision inherent in the deferral calculation does not have a counterpart in AFUDC, which is the return allowed on Construction Work in Progress ("CWIP"), because the amount of CWIP that is booked is specific and precise, and AFUDC is applied to that specific and precise amount (Staff Reply Br. at 7). Staff also argues that APS' comparison of the deferral to CWIP and AFUDC is also inapplicable because of timing, in that during the time that plant is under construction, it is not providing service, and the company is therefore unable to earn any revenues related to it, unless CWIP is afforded rate base treatment or AFUDC is authorized on the CWIP balance (Staff Reply Br. at 7). Staff asserts that in contrast, the Sundance Plant is already constructed, and APS should be able to earn revenue from the plant immediately upon acquisition (*Id.*).

Staff correctly points out that the fact that the Sundance Plant is already constructed and in operation differentiates it from a case where AFUDC might be allowed on CWIP. As explained in our discussion above regarding whether a deferral should be allowed in the absence of a PSA, were it not for the 90/10 percent sharing of costs and savings required by the proposed PSA, a deferral would not be justified at all. Once the prudently incurred costs of the Sundance Plant have been determined in the context of a rate case in which all factors have been considered, APS should certainly be authorized to earn a return on its prudent investment, but it should not earn that return retroactively to the acquisition date. Allowing deferral of a return on the deferred balance in addition to deferral of the costs prior to the plant's inclusion in rate base would unreasonably skew the benefits of regulatory lag in favor of the shareholders to the detriment of the ratepayers. As discussed above,

[12] Staff recommends that in the event a return is allowed, APS should be required to record and maintain the deferred costs by month in order to ensure that the necessary data will be available should recovery of any deferred costs be denied in the next rate proceeding (Exh. S-1 at 13), and that the proposed cost of debt in the pending APS rate case settlement is a reasonable return to use (*Id.*).

once the plant is in rate base, APS will continue to earn a return on the plant after the plant's actual retirement but before it is removed from rate base in a rate case. This proposed condition is reasonable and will be adopted.

7. Staff's Proposed Condition No. 7 - No Deferral of Overhead Costs

Staff recommended that an accounting deferral order be granted subject to the following Condition No. 7:

7. Overhead costs shall not be deferred.

APS agrees with this condition (APS Br. at 16). It is reasonable and will be adopted.

8. Staff's Proposed Condition No. 8 - Operation of Deferral

Staff recommended in its direct testimony that an accounting deferral order be granted subject to the following Condition No. 8:

8. Deferred direct costs shall only be debited when supported by an analysis conducted by the Company demonstrating that those costs have not been otherwise recovered.

Staff believes that revenue growth due to APS' load growth represents recovery of at least a portion, and potentially all, of the Sundance Plant costs (Exh. S-1 at 11). The Company did not provide projections of when revenue growth might increase to a level that would provide recovery of the Sundance Plant costs (Tr. at 212). Condition No. 8 as initially proposed above did not specify the type of analysis the Company should conduct prior to debiting deferred direct costs in order to demonstrate that the costs have not otherwise been recovered, or who would determine whether the analysis actually "demonstrated" that the costs have not otherwise been recovered. Condition No. 8 also did not identify what treatment the deferral order would afford the costs of APS' Track B contract with PPL Sundance that are encompassed in rates in the proposed settlement agreement in

APS' pending rate case.[13] Staff's witness stated that while Staff did not know the amount of the fixed costs of the Sundance Plant that are included in the Track B contract, APS would need to provide analysis showing that costs have not been recovered before actually deferring them (Tr. at 205, 206). Staff's witness also stated that it would be up to APS to determine what its analysis demonstrates for purposes of debiting the deferral account, and that while APS would be required to report projections monthly, the actual review of the Company's analysis would be undertaken at the time of a rate case, in order to determine whether the deferred amounts should actually be recovered through rates, with all factors being taken into account (Tr. at 206-208).

In its October 12, 2004 post-hearing filing, APS proposed additional language for Staff's proposed Condition No. 8, such that Condition No. 8 would read as follows (APS' additional language is underlined):

> 8. Deferred direct costs shall only be debited when supported by an analysis conducted by the Company demonstrating that those costs have not been otherwise recovered. To determine whether or not costs have been otherwise recovered, for each quarter APS shall compare its adjusted return on average equity (excluding competitive energy trading and purchases for resale) for the previous twelve months as filed with the Commission with the cost of equity last found reasonable in a Company rate proceeding. If the actual return exceeds the authorized return, the amount of the deferral for the quarter shall be reduced by the difference between the actual and authorized return times the actual average equity for such twelve month period.

In its October 19, 2004 post-hearing filing, Staff proposed alternative additional language for Condition No. 8, such that Condition No. 8 would read as follows (Staffs' additional language is underlined):

> 8. Deferred direct costs shall only be debited when supported by an analysis conducted by the Company demonstrating that those costs have not been otherwise recovered. To calculate the amount of eligible deferred costs that have been otherwise recovered, APS will compare each month, for each of its unbundled rate schedules, the current monthly energy and demand volumes billed to the corresponding monthly base volumes used

[13] In their post-hearing filings, both APS and Staff agreed that this issue would be best addressed by additional language added to Staff's proposed Condition No. 11, which is discussed below.

> to establish those generation rates. APS will then apply a fixed cost rate (FCR) for each rate schedule to the energy and demand differences. The products of those calculations shall be deemed costs recovered and deducted from the balance of deferred costs eligible for recovery. The FCR for each rate schedule is equal to the generation rate less the base cost of fuel and purchased power.

In its October 19, 2004 post-hearing Staff Report, Staff asserts that APS' October 12, 2004 proposal to use return on average equity for the previous twelve months does not measure the issue posed by Condition No. 8, which is whether Sundance Plant costs have been otherwise recovered (October 19, 2004 post-hearing Staff Report at 4). Staff contends that average return is a broad measure of financial performance that includes performance not only in the subject generation operations, but also in transmission and distribution operations (*Id.*). Staff believes that inclusion of transmission and distribution operations in the measurement fails to capture the results of generation cost recovery, because under-recovery of costs in transmission and distribution operations could mask the full recovery of generation costs (*Id.*). Staff believes that its alternative recommendation for the calculation of costs that have already been recovered provides a better means of measuring recovery of Sundance Plant costs, because it isolates generation activity from other operations (*Id.* at 5). Staff also argues that use of return on average equity for the previous twelve months would introduce an expected under-performance bias in the initial deferral period, because APS is currently experiencing earnings below its cost of capital (*Id.*).[14]

APS states on brief that it does not oppose a more focused test for Condition No. 8 that looks to generation rather than bundled rates (APS Reply Br. at 8). APS argues, however, that the methodology in Staff's proposed additional language for Condition No. 8 does not reflect cost increases attributable to generation in addition to costs associated with the Sundance Plant, such as increased operation and maintenance costs, pollution control retrofits at APS power plants, and other capital projects associated with incremental generation revenues (APS Reply Br. at 8). APS states

[14] Staff states that Staff, APS and other parties as signatories to the docketed settlement agreement in APS' pending rate case have acknowledged that APS is experiencing earnings below its cost of capital.

that it presented Staff and RUCO with a revised test for Condition No. 8 that reflects APS' position, and that APS will make a filing that includes the revised test if agreement is reached (*Id.*). No agreed-upon language has been filed subsequent to APS' Reply Brief. APS requests that if this Decision approves Condition No. 8 as proposed by Staff, that it be specifically noted that the implementation of Condition No. 8 should include consideration of generation costs as well as generation revenues before reducing the deferrals (APS Reply Br. at 8-9).

Staff characterizes its proposed methodology as an attempt to quantify APS' incremental generation revenues related to fixed costs (Staff Reply Br. at 9). Staff states in its "Exhibit 1" to the attached Exhibit C that the unbundled generation rates in the proposed settlement agreement in the pending APS rate case include the fixed and variable costs of generation. Staff notes that by definition, variable costs increase with increased generation, and that APS will need the variable portion of the generation rates to provide revenue to cover variable costs related to growth, but that "since fixed costs do not vary with growth, the incremental revenue generated by the fixed portion of generation rates represents revenue available to offset the cost of new generation assets such as the Sundance Generation Station" (*See* "Exhibit 1" to attached Exhibit C).

APS apparently disagrees with Staff's assertion that "fixed costs do not vary with growth" (*See* APS Reply Br. at 8). It appears, however, that Staff is referring to the fixed costs associated with the unbundled generation rates proposed in the settlement agreement in the pending APS rate case. The settlement agreement's proposed unbundled generation rates are based on generation assets that the parties to the settlement agreement have agreed were prudently acquired and are used and useful.

APS' request to include additional, yet-unknown new generation costs to the deferral methodology is problematic in that it would add yet another inexact and unknown input to a methodology designed to approximate costs that have been otherwise recovered. Accepting APS'

proposition to use as-yet-undetermined "cost increases attributable to generation in addition to costs associated with the Sundance Plant, such as increased operation and maintenance costs, pollution control retrofits at APS power plants, and other capital projects associated with incremental generation revenues" in calculating the amount of eligible deferred costs that have been otherwise recovered would serve only to further exacerbate an already imprecise exercise. We decline to add yet another speculative input to the estimation of costs that have been otherwise recovered.

Staff's proposed fixed cost rate is associated with APS' rate based generating units, which APS states may be displaced in the dispatch order by the more efficient Sundance Plant units (*See* Exh. APS-1 at 8; Tr. at 108, 109). The application of Staff's proposed methodology should ensure that capital costs associated with the Sundance Plant's displacement of rate based units are not deferred. Condition No. 8 as proposed by Staff in its October 19, 2004 filing provides a reasonable methodology for determining Sundance Plant costs not otherwise recovered. Condition No. 8 as proposed by Staff, with Staff's proposed additional language, will therefore be adopted.

9. Staff's Proposed Condition No. 9 - Use of Projections

Staff proposed Condition No. 9 as follows:

> 9. Projections may be used to calculate the net savings components (fuel costs, purchased power and off-system sales) of deferred costs. The projections shall have identical parameters, except to recognize the inclusion of the Sundance Generation Station, to eliminate bias and manipulation and to facilitate accurate measurement of net savings.

APS agrees with this condition (APS Br. at 17). The projection methodology proposed by APS, as discussed on pages 19-20 above, should ensure that the savings in operating expenses resulting from the addition of the Sundance Plant to APS' existing dispatch order will reduce cost deferrals. However, the language in this condition does not confirm APS' proposal that, based on the results of its projection methodology, the proposed PSA would be adjusted for the actual fuel and purchase power costs, net of off-system sales revenues, to calculate the PSA balance as if the acquisition did not occur. We agree with APS that such an adjustment would be consistent with the

proposed deferral of costs related to the Sundance Plant acquisition, and should be made. For clarity, this condition should include language requiring APS to adjust for the PSA the actual fuel and purchase power costs, net of off-system sales revenues, to calculate the PSA balance as if the Sundance Plant acquisition had not occurred, and should also include language referencing the projection methodology proposed in this proceeding, as follows (additional language is underlined):

> 9. Projections may be used to calculate the net savings components (fuel costs, purchased power and off-system sales) of deferred costs, as proposed by APS as described on pages 19-20 of this Decision. The projections shall have identical parameters, except to recognize the inclusion of the Sundance Generating Station, to eliminate bias and manipulation and to facilitate accurate measurement of net savings. As proposed by APS, based on the results obtained by analysis of these projections, the PSA shall be adjusted using the actual fuel and purchase power costs, net of off-system sales, resulting from these projections to calculate the PSA balance as if the Sundance Plan acquisition had not occurred.

With the additional clarifying language added as above, this condition is reasonable and will be adopted.

10. Staff's Proposed Condition No. 10 - Monthly Reporting Requirements

Staff proposed Condition No. 10 as follows:

> 10. The results of the projections shall be reported as part of the monthly filings required for the PSA.

APS agrees with this condition (APS Br. at 18). It is reasonable and will be adopted.

11. Staff's Proposed Condition No. 11 - Participation in Net Savings/Costs and Accounting for Track B Contract Costs

In their respective post-hearing filings, APS and Staff proposed identical additional language for Condition No. 11, such that Condition No. 11 would read as follows (the agreed-upon additional language is underlined):

> 11. APS shall participate in the net savings/costs related to fuel and purchased power costs and off-system sales at the same percentage rate as it participates in the PSA. Provided, however, that the deferral shall be further reduced by the portion of the avoided capacity payments resulting from the termination of the PPL Track B contract that would otherwise have been retained by APS under its participation in the proposed PSA, to

ensure that all avoided costs from the termination of such contract benefit customers.

If the PSA is adopted in APS' pending rate case and if the requested deferral is granted in this case, the practical effect of this proposed condition would be that savings customers would experience under the PSA that are attributable to the Sundance Plant acquisition (90 percent of savings) would be deferred, along with the costs that are attributable to the Sundance Plant acquisition, until APS' next rate case (Tr. at 291), when the deferred savings would be netted against the deferred costs for analysis and consideration of recovery in rates (Tr. at 294, 295, 302-303). The rates proposed in APS' pending rate case settlement agreement include the costs of the Track B APS/PPL contract, and APS will recover that portion of the fixed costs of the Sundance Plant that were included in the Track B contract costs in base rates if the settlement agreement is approved. The additional language proposed by Staff and APS for this Condition No. 11 will ensure that those costs will not be deferred for consideration of recovery in APS' next rate case. In conjunction with the additional clarifying language that we add to Condition No. 9, as discussed above, this condition is reasonable and will be adopted.

E. Deferral Order - Proposed Language

In its October 12, 2004 post-hearing filing, APS proposed revised language for its proposed specific Ordering Paragraphs as follows:

> IT IS THEREFORE ORDERED that Arizona Public Service Company is granted an accounting/rate-making Order to defer, for later recovery through rates, the costs,[1] net of any savings,[2] of owning, operating, and maintaining the Sundance Generating Station and associated facilities. Nothing in this Decision shall limit the Commission's authority to review the acquisition and to make disallowances thereof due to imprudence.[3]
>
> IT IS FURTHER ORDERED that Arizona Public Service Company's authority to defer costs is limited to ___[4] months from the date that APS acquires the Sundance Generating Station.

IT IS FURTHER ORDERED that the accumulated deferral balance associated with all amounts deferred pursuant to this Decision shall be included in cost of service for rate-making purposes in Arizona Public Service Company's next rate case. Nothing in this Decision shall limit the Commission's authority to review such balance and to make disallowances thereof due to imprudence, errors or inappropriate application of the order, but any such review shall consider the total costs incurred by APS.

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[1] Excluding overhead costs.

[2] Savings are fuel and purchased power savings and off-system sales margins resulting from the acquisition of Sundance.

[3] The last sentence would apply if Staff's position on APS' request for a prudence finding is adopted. If the Commission were to conclude at this time that the acquisition was prudent, this sentence would not be necessary.

[4] Either 36 months or 60 months depending on the Commission's resolution of the term of the deferral. Also, this revised schedule does not address APS' request for a debt return on the balance of the deferral.

In its October 19, 2004 post-hearing filing, Staff also proposed language for specific Ordering Paragraphs as follows:

IT IS THEREFORE ORDERED that Arizona Public Service Company is authorized to defer, for later recovery through rates, the costs,[1] net of any savings,[2] of owning, operating, and maintaining the Sundance Generating Station subject to the conditions adopted herein.[3] Nothing in this Decision shall limit the Commission's authority to review the acquisition and to make disallowances thereof due to imprudence, errors or inappropriate application of the order.

IT IS FURTHER ORDERED that Arizona Public Service Company's authority to defer costs is limited to 36 months from the later of the date that APS acquires the Sundance Generating Station or the new rates go into effect and only if the Power Supply Adjuster in the APS rate case is adopted.

IT IS FURTHER ORDERED that the accumulated deferred balance associated with all amounts deferred pursuant to this Decision will be included in cost of service for rate-making purposes in Arizona Public Service Company's next general rate case. Nothing in this Decision shall limit the Commission's authority to review such balance and to make disallowances thereof due to imprudence, errors or inappropriate application of the order.

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[1] Excluding overhead costs.

[2] Savings are fuel and purchased power savings and off-system sales margins resulting from the acquisition of the Sundance Generating Station.

[3] Recommendations are those set forth in Mr. Moe's Direct Testimony.

Consistent with the discussion herein, the deferral language proposed by Staff is reasonable and will be adopted.

VI. CEC Modification

The Joint Application requested modification of one condition in the CEC issued for the Sundance Plant to conform it to more recent CECs, and confirmation that the CEC is currently valid and effective. Two dockets are open in this proceeding. While the primary docket addresses the proposed acquisition, the second docket pertains to the CEC issued by the Power Plant and Transmission Line Siting Committee which was approved by this Commission with certain additional conditions. Condition 16, which was added by the Commission ("Condition 16"), provides as follows:

> The authority to construct facilities granted by this Commission Decision shall be revoked and the associated Certificate rendered null and void in its entirety without further order of the Commission, if the Applicant, or its successor(s) or assignee(s):
>
> 1. Legally challenges any condition herein, OR
> 2. Fails to comply with any condition herein.

PPL Sundance requests that CEC compliance be confirmed for all periods prior to the effective date of a Commission order in this proceeding, and that Condition 16 be modified to include reasonable opportunity for notice and hearing prior to legal effectiveness of any future action impairing the validity of the CEC.

A. Confirmation that the CEC is Currently Valid and Effective

PPL Sundance asserts that for immediate purposes of contractual certainty, both PPL Sundance and APS need confirmation that there has been no "automatic" revocation of the CEC to date and that the CEC is in full force and effect (PPL Sundance Br. at 12). PPL Sundance avers that it has never legally challenged any provision of the CEC (*Id.*).

PPL Sundance's witness testified in this proceeding that it is in compliance with its CEC. (Exhibit PPL-3 at 7-10; Tr. at 311). Staff also testified that it believes PPL Sundance is in

compliance (Tr. at 340), and no intervenors in this proceeding, which was duly noticed, made any claim or presented any evidence that PPL Sundance was not in compliance with its CEC. It is therefore reasonable to confirm that, based on the record evidence presented in this proceeding, the CEC is currently valid and effective.

B. Modification of the CEC

PPL Sundance contends that the second prong of Condition 16 creates uncertainty regarding the validity of the CEC because it arguably provides for "automatic" invalidation upon any violation of the other CEC terms and conditions, without any process or action by the Commission; that the condition lacks a materiality test for such violations; and that, by reason of some presently unidentified and unknown, but previously occurring violation, the CEC could be automatically revoked retroactive to the time of such alleged occurrence "without further order of the Commission" (PPL Sundance Br. at 12-13).

PPL Sundance believes that Condition 16 should be modified independent of all other relief requested in this proceeding, because it would enable PPL Sundance to sell the Sundance Plant to another entity, if necessary, without having to come back to this Commission again on the issue (Rebuttal Testimony of Bradley E. Spencer, Exh. PPL-4 at 2). PPL Sundance argues that if a compelling rationale for modification exists in this case, that the rationale is equally compelling while PPL Sundance holds the CEC (PPL Sundance Br. at 15).

Staff disagrees, and states that it does not object to amending Condition 16 if APS acquires the Sundance Plant, but does object to the proposed amendment if APS does not acquire the Sundance Plant (Staff Reply Br. at 8). Staff states that PPL Sundance's request for amendment regardless of the acquisition was made only in PPL Sundance's rebuttal testimony, after Staff had filed its direct testimony, and after the cutoff date for discovery in this matter, and that consequently, Staff did not have an opportunity to evaluate the effect of the amendment in the event that PPL Sundance retains ownership of the Sundance Plant (*Id.*). Staff's witness testified that if the

acquisition does not consummate and a future buyer files an application with the Commission, the CEC provision would have to be reviewed in conjunction with all the requirements of the sale to determine if it should or should not be changed (Tr. at 376).

Staff proposes that if APS acquires the Sundance Plant, Condition 16 of the CEC be modified to provide as follows:

> 16. If the applicant, its successor(s) or assignee(s), after notice and hearing, is found to have failed to comply with any condition herein, the Commission shall impose appropriate sanctions up to and including revocation of the authority to construct facilities granted by the Commission, which would result in the CEC being rendered null and void in its entirety.

PPL consents to the language proposed by Staff (*See* Exh. PPL-4 at 1), but also provides the following alternative language:

> 16. If the applicant, its successor(s) or assign(s), after notice and hearing, is found to have failed to comply with any condition herein, the Commission shall impose such sanctions or other remedy as the Commission deems appropriate under the circumstances, up to and including revocation of this certificate.

We agree with PPL Sundance's argument that the rationale for modification that exists in this case is equally compelling while PPL Sundance holds the CEC. Staff's proposed modification language is reasonable and will be adopted to replace Condition 16 of the CEC whether or not APS acquires the Sundance Plant.

VII. Other Issues: "Regulatory Out" Provision and Precedential Value of this Decision

Two additional issues beyond the relief requested in the Joint Application were raised. One is the request of Staff for a specific determination that "regulatory out" provisions such as that in Section 8.7(b) of the Asset Purchase Agreement are not generally appropriate, and the other is the general issue of the precedential value of this Decision.

A. "Regulatory Out" Provision – (Section 8.7(b) of the Asset Purchase Agreement)

1. Arguments

Staff points out that the parties to this transaction have chosen to include conditions in the

Asset Purchase Agreement that permit APS to cancel the transaction if the Commission denies APS the relief that it has requested in this proceeding (Exh. S-3 at 4), and notes that this provision was included at the request of APS (Tr. at 92-93). Staff is concerned about the use of so-called "regulatory out" provisions such as those appearing in Section 8.7(b) of the Asset Purchase Agreement[15] (Exh. S-3 at 13). Staff recognizes that pre-approval may be appropriate in some circumstances, but requests that a specific determination be made, in this proceeding, that such "regulatory out" provisions such as that in Section 8.7(b) of the Asset Purchase Agreement are not generally appropriate (*Id.*).

Staff believes that regulatory pre-approval of asset acquisitions, absent extraordinary circumstances, leads to a negative incentive for the regulated entity by shifting risk from the regulated entity to ratepayers, and that in some sense, it actually shifts management responsibility from the regulated entity to the regulator, by eliminating the incentive for the regulated entity to find the best deal for its customers (Tr. at 367). Staff is also concerned that use of such pre-approval clauses in the future might force the Commission to review transactions at a time and on a schedule that places the Commission at a disadvantage, and that they might limit the breadth of the information before the Commission in a way that may adversely affect the public interest (Staff Br. at 11). Staff urges that consideration be given, in this case, to the issue of how such contractual provisions may be perceived and utilized in the future (*Id*).

APS cautions that the scope of Staff's request should be narrowly circumscribed, because every transaction of the magnitude of this acquisition requires numerous regulatory approvals in addition to those that might be requested from this Commission (APS Reply Br. at 5). APS cites as examples the Hart-Scott-Rodino approval from the Federal Trade Commission and the Department of Justice and FERC approval under Section 203 of the Federal Power Act (APS Reply Br. at 5). APS urges that Staff's request for a generic determination in this docket be denied, because 1) no rule or statute prohibits a utility from seeking prudence determinations; 2) no actual bidder commented on the regulatory approvals during the RFP process; and 3) it would be inappropriate to make a generic

[15] Section 8.7(b) of the Asset Purchase Agreement appears on page 42 of Hearing Exhibit APS-2, which is attached to this Decision as Exhibit A.

statement in a docket that involves a single regulated utility rather than in a generic proceeding where others in the industry could comment and participate (APS Reply Br. at 5-6). APS adds that establishing in this Decision that requests for prudence determinations are "generally inappropriate" would add uncertainty to complex transactions and act as a disincentive to utilities by adding "unnecessary regulatory risk" to such transactions (APS Reply Br. at 6).

PPL Sundance asserts that "Paragraph 8.7(b) of the agreement between PPL and APS could not be more clear" (PPL Sundance Reply Br. at 3), and makes the statement that "[o]nly by granting the requested approvals can the Commission help ensure that the transaction will close and that APS' ratepayers will receive the full benefits of ownership" (*Id.* at 4).

2. Analysis and Conclusion

It must be noted in response to PPL Sundance's statement quoted above that it is not this Commission's responsibility to "help ensure that the transaction will close." We do not believe that this Commission should be required to assume such a level of management responsibility for the activities of a functioning, responsible public service corporation such as APS. As we have clearly stated before, APS is responsible for the continuing need of its ratepayers to maintain a reliable supply of electricity at reasonable rates (Decision No. 65743 (March 14, 2003) "Track B Order" at 72, Findings of Fact No. 27). Even under the unique circumstances that led to the Track B Order[16] we stated that a regulated utility should have decision-making authority regarding its needs and the responsibility to act prudently, and we left the responsibility and choice of procurement squarely in the lap of the utility (Decision No. 65743 at 64, lines 10-20).

APS made a business decision to enter into the Asset Purchase Agreement, including Section 8.7(b), with PPL Sundance, presumably in order to provide for the continuing need of its ratepayers to maintain a reliable supply of electricity at reasonable rates. APS is responsible, as always, for its business decisions. The Asset Purchase Agreement, including Section 8.7(b), is an agreement between two contracting parties that is in no way binding on this Commission. It is therefore not

[16] "Secondly, the Track B Solicitation process is, rather than a 'mandated procurement,' the means by which this Commission is dealing with the fact that leading up to our determination, in Decision No. 65154, to stay the requirements of A.A.C. R14-2-1606(B), APS had chosen not to commence the competitive bid process that rule required, but had chosen instead to propose a variance from the rule in order to allow it to enter into a purchase power agreement with its affiliate PWEC." (Decision No. 65743 at 64- 65).

necessary to make a specific determination in this proceeding, as requested by Staff, that such "regulatory out" provisions such as that in Section 8.7(b) of the Asset Purchase Agreement are not generally appropriate.

We do note, however, that if APS makes a business decision to not proceed with the acquisition of Sundance under the "regulatory out" provision, nothing would preclude the Commission from evaluating the prudence of an alternative business decision in light of the benefits APS and its customers would have obtained if APS had not relied on the regulatory out provision to not go forward with its acquisition of Sundance.

B. Precedential Value of this Decision

1. Arguments

Sempra/Southwestern has raised the issue of the precedential value of this proceeding on future transactions involving the acquisition of generation assets owned by Independent Power Producers. Sempra/Southwestern presented no witnesses or exhibits at the hearing. On brief, however, Sempra/Southwestern posits four questions which Sempra/Southwestern believes are "generally applicable to any proposed sale of electric generation facilities by an independent power producer ("IPP") or merchant generator to a public service corporation regulated by the Commission, and upon which the Commission could offer general guidance as to when and how such questions should be addressed and resolved in the future, as well as in the instant proceeding" (Sempra/Southwestern Reply Br. at 2 (emphasis added); *see also* Sempra/Southwestern Br. at 4). In addition, Sempra/Southwestern suggests that adoption of certain language as recommended by Staff in this proceeding regarding pre-approval of the transaction would result in an enhancement to the regulatory process "by placing all market participants on notice of the treatment [this] Commission would give to any such proposed transaction" (Sempra/Southwestern Reply Br. at 5, emphasis added).

PPL Sundance states that it is troubled by arguments suggesting that the Commission use this proceeding to set generic policies or general approaches to issues involving acquisition of generation facilities by public utilities (PPL Sundance Reply Br. at 1). PPL Sundance raises concerns with both Sempra/Southwestern's request for guidance of a general nature on questions associated with asset

acquisitions by utilities, and with Staff's request for what PPL Sundance terms a "general pronouncement" that contractual provisions that require regulatory pre-approval as a condition to completing a transaction are not generally appropriate (*Id.* at 1). PPL Sundance argues that attempts to complicate or frustrate the narrow purpose of this proceeding by requesting generic policy pronouncements should be rejected, and suggests that this Decision include an ordering paragraph including specific language stating that this Decision should not be relied upon for the establishment of any "generic policies or precedents" (*Id.* at 3).

APS also believes that it would be inappropriate to make a generic statement in a docket that involves a single regulated utility rather than in a generic proceeding where others in the industry could comment and participate (APS Reply Br. at 5-6).

2. Analysis and Conclusion

In regard to the argument of Sempra/Southwestern that this Decision would "place all market participants on notice," we agree with the spirit of PPL Sundance's suggestion, if not with the need for PPL Sundance's specific language in this Decision. It is not this Commission's intent, by the determination herein of the appropriate action on the requested relief in this proceeding, to place "all market participants on notice of the treatment [this] Commission would give to any such proposed transaction" as iterated by Sempra/Southwestern (*see* Sempra/Southwestern Reply Br. at 5). It is not necessary, however, to adopt the language proposed by PPL Sundance regarding "generic policy or precedent," because this is not a generic proceeding, and we base our determination in this Decision solely on the Joint Application and on the facts related to the specific relief requested by APS and PPL Sundance as set forth in the Findings of Fact herein.

* * * * * * * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. On June 1, 2004, APS and PPL Sundance jointly filed the above-captioned application with the Commission. The application included the direct testimony of APS witnesses Steven M. Wheeler and Patrick Dinkel, and of PPL Sundance witnesses Joel D. Cook and Bradley E. Spencer.

2. On June 10, 2004, RUCO filed an Application to Intervene, which was granted by Procedural Order dated June 22, 2004.

3. On June 15, 2004, a copy of a Protective Agreement between Staff and PPL Sundance was filed in this docket.

4. On July 8, 2004, Mr. Jay I. Moyes filed a Motion and Consent of Local Counsel for Pro Hac Vice Admission of Jesse A. Dillon. By Procedural Order dated July 16, 2004, Mr. Dillon was admitted *pro hac vice* to appear in this docket.

5. On July 15, 2004, Walter W. Meek, President of the AUIA filed an Application to Intervene, which was granted by Procedural Order dated July 26, 2004.

6. On July 16, 2004, TEP filed an application to intervene, which was granted by Procedural Order dated July 2, 2004.

7. On August 10, 2004, Staff filed a Request for Procedural Order, in which Staff proposed a procedural schedule for a hearing in this docket. On August 11, 2004, a Procedural Order was issued setting a procedural conference for August 18, 2004, for discussion of a procedural schedule.

8. On August 20, 2004, a Procedural Order was issued setting the hearing for October 4, 2004 and setting associated procedural deadlines, including the publication of notice of the hearing, discovery deadlines, and dates for pre-filing direct and rebuttal testimony.

9. On September 3, 2004, Constellation NewEnergy, Inc. and Strategic Energy, LLC jointly filed an Application for Leave to Intervene, which was granted by Procedural Order dated September 14, 2004.

10. On September 3, 2004, APS filed certification that notice of the hearing in this matter was published in the *Arizona Republic* on August 30, 2004. On September 8, 2004, APS filed an Affidavit of Publication verifying the publication of notice.

11. On September 7, 2004, Sempra/Southwestern filed Applications for Leave to Intervene, which were granted by Procedural Order issued September 14, 2004.

12. AUIA filed the direct testimony of Walter W. Meek on September 16, 2004. RUCO filed the direct testimony of its witness Marylee Diaz Cortez on September 17, 2004. Staff filed the

direct testimony of its witnesses Matthew Rowell and William Gehlen on September 17, 2004, and filed the direct testimony of its witness Jamie R. Moe on September 21, 2004.

13. PPL Sundance filed the rebuttal testimony of its witnesses Joel D. Cook and Bradley E. Spencer on September 27, 2004. APS filed the rebuttal testimony of its witnesses Steven M. Wheeler and Patrick Dinkel on September 27, 2004.

14. The hearing in this matter commenced as scheduled on October 4, 2004. No members of the public appeared to provide public comment. The hearing concluded on October 5, 2004. At the close of the hearing, it was agreed that either APS, or APS jointly with Staff, would file a late-filed exhibit on October 12, 2004, and that all parties would file any comments on the October 12, 2004 filing by October 19, 2004.

15. On October 12, 2004, APS filed a Notice of Submission of Late-Filed Exhibit. APS' filing included a Revised Schedule PD-4 which reflected its proposal for an accounting order.

16. On October 19, 2004 Staff filed a Notice of Filing Staff's Response to APS' Late-Filed Exhibit. Staff's response was in the form of a Staff Report and Exhibits 1 through 3.

17. On October 22, 2004 APS, PPL Sundance, AUIA, Sempra/Southwestern, RUCO and Staff filed Initial Closing Briefs. RUCO filed a Notice of Errata on October 27, 2004.

18. On November 5, 2004, APS, PPL Sundance, RUCO and Staff filed Reply Closing Briefs. Sempra/Southwestern filed a Reply Closing Brief on November 9, 2004.

19. On June 1, 2004, APS and PPL Sundance entered into an Asset Purchase Agreement for the sale to APS of the Sundance Plant.

20. In the June 1, 2004 Joint Application, APS and PPL Sundance requested: 1) approval of the transaction; 2) a determination that the acquisition is prudent and that the plant is used and useful; 3) confirmation that the Sundance Plant will be afforded traditional cost of service treatment in the future; 4) confirmation that APS' existing financing authority can be used to finance the acquisition; 5) a deferred accounting order authorizing APS to defer for future recovery a portion of the capital and operating costs associated with the acquisition of the Sundance Plant, net of cost savings to APS from the acquired assets; and 6) modification of one condition of the CEC issued for the Sundance Plant to conform it to more recent CECs and confirmation that the CEC is currently

valid and effective.

21. Approval of the acquisition as requested, prior to its consideration in a ratemaking proceeding, could hinder the Commission's ability to consider on a *de novo* basis in a ratemaking proceeding the prudence of the acquisition and the extent to which the acquired assets are "used and useful" for ratemaking purposes.

22. The circumstances of this case do not justify the potential for premature rate relief that Commission approval of the acquisition prior to a rate proceeding would bring about. However, it is appropriate in this proceeding to dispel any uncertainty or confusion regarding APS' current ability to self-build or buy new generation assets for native load.

23. APS currently has the ability, subject to applicable regulatory requirements, to self-build or buy new generation assets for native load. APS has the obligation to plan for and serve all customers in its certificated service area, irrespective of size, and to recognize, in its planning, the existence of any Commission direct access program and the potential for future direct access customers. A proposed settlement agreement in APS' pending rate case in Docket No. E-01345A-03-0437, which has not yet been acted upon, seeks to set certain limits on APS' current ability to "self-build."

24. The record in this proceeding does not include an evaluation of the factors that FERC normally considers in a Section 203 approval proceeding. This Decision's determination that pre-approval of the acquisition is inappropriate and not in the public interest, due to ratemaking considerations, will therefore not be relevant to FERC's disposition of the APS and PPL Sundance application for Section 203 approval.

25. It would be speculative, and therefore improper, to make either a full or partial determination at this time whether APS will have "prudently invested" in the Sundance Plant assets, which it has yet to acquire, or whether the assets are used and useful.

26. When in the context of a ratemaking proceeding a public service corporation requests rate relief for assets not previously accorded rate base treatment, the request is considered under traditional cost of service ratemaking principles, which include examination and evaluation of all rate base issues in the context of the public service corporation's total operations.

27. It would be premature to determine at this time that the Sundance Plant acquisition will satisfy the evidentiary and legal standards necessary to be accorded full cost recovery under traditional cost of service principles in a future rate proceeding. However, if APS requests rate relief for the Sundance Plant in the context of a ratemaking proceeding, the request will be considered under traditional cost of service ratemaking principles, which include examination and evaluation of all rate base issues in the context of APS' total operations.

28. The financing authorizations granted in Decision No. 54230 (November 8, 1984) and Decision No. 55017 (May 6, 1986) remain in full force and effect, and can be used for the acquisition of the Sundance Plant. Existing long-term debt authority remaining under the caps set by those Decisions is approximately $482 million.

29. Conditioned upon this Commission's approval of the proposed PSA in the pending APS rate case in Docket No. E-01345A-03-0437, APS should be authorized to defer, for later recovery through rates, the costs, excluding overhead costs, net of any savings, which consist of fuel and purchased power savings and off-system sales margins, of owning, operating, and maintaining the Sundance Generating Station subject to the following conditions and their operation as discussed herein:

1) No deferrals shall be recorded unless a PSA is adopted in APS' pending rate case that recognizes off-system sales as a credit (reduction) to the recoverable balance.

2) The deferral period shall not begin until the PSA becomes effective.

3) Debits (additions) to the deferred costs shall be made only in the months that the PSA remains in effect.

4) Debits to the deferred costs shall terminate no later than 36 months from the later of the date that APS acquires the Sundance Plant or the date the new rates in the pending APS rate case go into effect, unless APS has a general rate case pending at the end of the 36-month period, in which case APS may continue to defer costs associated with the acquisition of the Sundance Plant until such rate case is concluded. APS' next rate case shall address the deferred amounts recorded as of ninety days before the due date for filing Staff's Direct Testimony. Any additional properly deferred amounts recorded after that date may be considered in subsequent rate case(s).

5) Debits to the deferred costs shall terminate on the effective date of rates authorized in any rate case subsequent to the pending rate case.

6) No cost of money factor shall be applied to any deferred amounts.

7) Overhead costs shall not be deferred.

8) Deferred direct costs shall only be debited when supported by an analysis conducted by the Company demonstrating that those costs have not been otherwise recovered. To calculate the amount of eligible deferred costs that have been otherwise recovered, APS will compare each month, for each of its unbundled rate schedules, the current monthly energy and demand volumes billed to the corresponding monthly base volumes used to establish those generation rates. APS will then apply a fixed cost rate (FCR) for each rate schedule to the energy and demand differences. The products of those calculations shall be deemed costs recovered and deducted from the balance of deferred costs eligible for recovery. The FCR for each rate schedule is equal to the generation rate less the base cost of fuel and purchased power.

9) Projections may be used to calculate the net savings components (fuel costs, purchased power and off-system sales) of deferred costs, as proposed by APS as described on pages 19-20 of this Decision. The projections shall have identical parameters, except to recognize the inclusion of the Sundance Generating Station, to eliminate bias and manipulation and to facilitate accurate measurement of net savings. As proposed by APS, based on the results obtained by analysis of these projections, the PSA shall be adjusted using the actual fuel and purchase power costs, net of off-system sales, resulting from these projections to calculate the PSA balance as if the Sundance Plant acquisition had not occurred.

10) The results of the projections shall be reported as part of the monthly filings required for the PSA.

11) APS shall participate in the net savings/costs related to fuel and purchased power costs and off-system sales at the same percentage rate as it participates in the PSA. Provided, however, that the deferral shall be further reduced by the portion of the avoided capacity payments resulting from the termination of the PPL Sundance Track B contract that would otherwise have been retained by APS under its participation in the proposed PSA, to ensure that all avoided costs from the termination of such contract benefit customers.

30. PPL Sundance has never legally challenged any provision of the CEC granted in

Decision No. 63863 (July 9, 2001).

31. Based on the record evidence presented in this proceeding, PPL Sundance is in compliance with the CEC granted in Decision No. 63863.

32. Based on the record evidence presented in this proceeding, the CEC granted in Decision No. 63863 is currently valid and effective.

33. Because the rationale for modification of Condition 16 of the CEC that exists in this case is equally compelling while PPL Sundance holds the CEC, Condition 16 of the CEC granted in Decision No. 63863 is modified to read as follows: "16. If the applicant, its successor(s) or assignee(s), after notice and hearing, is found to have failed to comply with any condition herein, the Commission shall impose appropriate sanctions up to and including revocation of the authority to construct facilities granted by the Commission, which would result in the CEC being rendered null and void in its entirety."

CONCLUSIONS OF LAW

1. APS is a public service corporation within the meaning of Article XV of the Arizona Constitution.

2. The Commission has jurisdiction over APS and the subject matter of the Joint Applications.

3. Notice of this proceeding was given as required by law.

4. Pursuant to A.R.S. § 40-361, every public service corporation shall furnish and maintain such service, equipment and facilities as will promote the safety, health, comfort and convenience of its patrons, employees and the public, and as will be in all respects adequate, efficient, and reasonable.

5. The financing authorizations granted in Decision No. 54230 (November 8, 1984) and Decision No. 55017 (May 6, 1986) remain in full force and effect. The acquisition of the Sundance Plant is a proper use for those financing authorizations.

6. It is reasonable and in the public interest to authorize APS to defer, for later recovery

through rates, the costs, excluding overhead costs, net of any savings, which consist of fuel and purchased power savings and off-system sales margins, of owning, operating, and maintaining the Sundance Generating Station subject to the operation of Condition Nos. 1 through 11 as discussed and adopted herein.

7. The cost deferral authorization as granted herein does not constitute a finding or determination that the costs are reasonable, appropriate, or prudent.

8. This Decision should not be construed to limit this Commission's authority to review the acquisition at the appropriate time and to make disallowances thereof due to imprudence, errors or inappropriate application of the requirements of this Decision.

9. This Decision should not be construed to limit this Commission's authority to review the accumulated deferred balance associated with all amounts deferred pursuant to this Decision and to make disallowances thereof due to imprudence, errors or inappropriate application of the requirements of this Decision.

10. Based on the record evidence presented in this proceeding, the CEC granted in Decision No. 63863 is currently valid and effective.

11. It is reasonable and appropriate to modify Condition 16 of the CEC granted in Decision No. 63863.

ORDER

IT IS THEREFORE ORDERED that conditioned upon this Commission's approval of the Power Supply Adjuster as proposed in the settlement agreement in the pending Arizona Public Service Company rate case in Docket No. E-01345A-03-0437, Arizona Public Service Company is authorized to defer, for possible later recovery through rates, the costs, excluding overhead costs, net of any savings, which consist of fuel and purchased power savings and off-system sales margins, of owning, operating, and maintaining the Sundance Generating Station subject to the conditions adopted herein. Absolutely nothing in this Decision shall be construed in any way to limit this Commission's authority to review the entirety of the acquisition and to make any disallowances thereof due to imprudence, errors or inappropriate application of the requirements of this Decision.

IT IS FURTHER ORDERED that Arizona Public Service Company's authority to defer costs

is limited to 36 months from the later of the date that Arizona Public Service Company acquires the Sundance Generating Station or the new rates go into effect, unless APS has a general rate case pending at the end of the 36-month period, in which case APS may continue to defer costs associated with the acquisition of the Sundance Plant until such rate case is concluded. APS' next rate case shall address the deferred amounts recorded as of ninety days before the due date for filing Staff's Direct Testimony. Any additional properly deferred amounts recorded after that date may be considered in subsequent rate case(s).

IT IS FURTHER ORDERED that the accumulated deferred balance associated with all amounts deferred pursuant to this Decision will be included in cost of service for rate-making purposes in Arizona Public Service Company's next general rate case. Nothing in this Decision shall be construed to limit this Commission's authority to review such balance and to make disallowances thereof due to imprudence, errors or inappropriate application of the requirements of this Decision.

IT IS FURTHER ORDERED that Conditions 1 through 11 as discussed herein shall apply to the deferral authorization.

IT IS FURTHER ORDERED that Arizona Public Service Company shall prepare and retain accounting records sufficient to permit detailed review, in a rate proceeding, of all deferred costs recorded as authorized herein.

IT IS FURTHER ORDERED that Condition 16 of the Certificate of Environmental Compatibility granted in Decision No. 63863 (July 9, 2001) shall be modified to read as follows:

"16. If the applicant, its successor(s) or assignee(s), after notice and hearing, is found to have failed to comply with any condition herein, the Commission shall impose appropriate sanctions up to and including revocation of the authority to construct facilities granted by the Commission, which would result in the CEC being rendered null and void in its entirety."

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IT IS FURTHER ORDERED that Arizona Public Service Company shall make a notification filing in this docket within thirty days of either closing or abandoning the transaction.

IT IS FURTHER ORDERED that this Order will not be used as precedent and is entered based on the unique facts and circumstances of this case.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER COMMISSIONER

COMMISSIONER COMMISSIONER

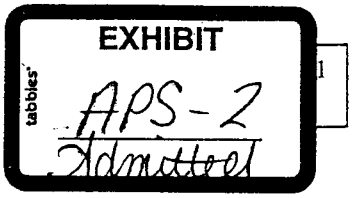
IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 20th day of Jan., 2005.

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT _____

DISSENT _____

TW:mj



ASSET PURCHASE AGREEMENT

by and between

PPL SUNDANCE ENERGY, LLC
as Seller

and

ARIZONA PUBLIC SERVICE COMPANY
as Purchaser

dated as of June 1, 2004

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ASSET PURCHASE AGREEMENT

This Asset Purchase Agreement (this "*Agreement*") dated as of June 1, 2004 (the "*Agreement Date*") is made and entered into by and between **PPL Sundance Energy, LLC**, a Delaware limited liability company ("*Seller*"), and **Arizona Public Service Company**, an Arizona corporation ("*Purchaser*").

RECITALS

Seller owns a generating plant in Pinal County, Arizona, having a nominal generating capacity of 450 megawatts.

Seller desires to sell and assign to Purchaser, and Purchaser desires to purchase and assume from Seller, the Purchased Assets and the Assumed Liabilities (each as hereinafter defined) on the terms and subject to the conditions set forth herein.

STATEMENT OF AGREEMENT

Now, therefore, in consideration of the premises and the mutual representations, warranties, covenants and agreements set forth in this Agreement, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties agree as follows:

ARTICLE I

DEFINITIONS; CONSTRUCTION

1.1 *Definitions*. Capitalized terms used in this Agreement have the meanings given to them in Appendix I to this Agreement.

1.2 *Construction*.

(a) In this Agreement, unless expressly provided otherwise:

(i) Unless otherwise specified, all article, section, subsection, schedule, exhibit and appendix references used in this Agreement are to articles, sections, subsections, schedules, exhibits and appendices to this Agreement. The exhibits, schedules and appendices attached to this Agreement constitute a part of this Agreement and are incorporated herein for all purposes.

(ii) If a term is defined as one part of speech (such as a noun), it shall have a corresponding meaning when used as another part of speech (such as a verb). Unless the context of this Agreement clearly requires otherwise the singular shall include the plural and the plural shall include the singular wherever and as often as may be appropriate, and words importing the masculine gender shall include the feminine and neutral genders and vice versa. The words "includes" or "including" shall mean "including without limitation," the words "hereof," "hereby," "herein," "hereunder" and similar terms in this Agreement

shall refer to this Agreement as a whole and not any particular section or article in which such words appear and any reference to a Law shall include any amendment thereof or any consolidation, amendment, reenactment, extension, replacement or successor thereto and any rules and regulations promulgated thereunder. References to "or" shall be deemed to be disjunctive but not necessarily exclusive (i.e., unless the context dictates otherwise, "or" shall be interpreted to mean "and/or" rather than "either/or"). Currency amounts referenced herein, unless otherwise specified, are in U.S. Dollars.

(iii) A reference to (A) a day (other than a Business Day) is a reference to a calendar day, (B) a month is a reference to a calendar month and (C) a year is a reference to a calendar year. A reference to a time is a reference to the time in effect in Phoenix, Arizona on the relevant date. When a period of time is specified to run from or after a given day or the day of an act or event, it is to be calculated exclusive of such day; and where a period of time is specified as commencing on a given day or the day of an act or event, it is to be calculated inclusive of such day. Whenever this Agreement refers to a number of days, such number shall refer to calendar days unless Business Days are specified. Whenever any action must be taken hereunder on or by a day that is not a Business Day, then such action may be validly taken on or by the next day that is a Business Day. A reference to a day (other than a Business Day) is a reference to a period of time commencing at midnight Phoenix time and ending the following midnight Phoenix time. A reference to a Business Day is a reference to a period of time commencing at 9:00 a.m. Phoenix time on a Business Day and ending at 5:00 p.m. Phoenix time on the same Business Day.

(iv) All accounting terms used herein and not expressly defined herein shall have the meanings given to them under GAAP.

(b) Time is of the essence in this Agreement.

(c) Each Party acknowledges that it and its attorneys have been given an equal opportunity to negotiate the terms and conditions of this Agreement and that any rule of construction to the effect that ambiguities are to be resolved against the drafting Party or any similar rule operating against the drafter of an agreement shall not be applicable to the construction or interpretation of this Agreement.

ARTICLE II

PURCHASE AND SALE

2.1 *Purchase and Sale*. On the terms and subject to the conditions set forth in this Agreement, at the Closing, Seller shall sell, assign, convey, transfer and deliver to Purchaser, and Purchaser shall purchase and acquire from Seller, free and clear of all Liens (except for Permitted Liens, including the Permitted Liens set forth on Schedule 2.1), all of Seller's right, title and interest in, to and under the real and personal property, tangible or intangible, constituting the Purchased Assets.

2.2 *Excluded Assets*. Notwithstanding any provision herein to the contrary, the Purchased Assets shall not include the following (collectively, the "*Excluded Assets*"):

(a) except for Prepayments, any cash, cash equivalents, certificates of deposit, bank deposits, commercial paper, securities, rights to payment, accounts receivable, rights to refunds, credits, offsets, in-kind or exchange arrangements, income, sales, payroll or other tax receivables, and any similar rights arising from or relating to the ownership or operation of the Business or the Project with respect to any period of time prior to the Closing;

(b) all claims, causes of action, rights of recovery, rights of set-off, rights to refunds and similar rights of any kind in favor of Seller or any other Person arising from or relating to the ownership or operation of the Business or the Project with respect to any period of time prior to the Closing, including any refund of Taxes paid prior to the Closing (including refunds of Taxes received after the Closing) and described in **Section 2.2(d)** below, except for (i) any of the foregoing that relate to Assumed Liabilities and (ii) the Warranty Rights;

(c) any rights of Seller or any other Person in the names "PPL" and "PPL Sundance Energy" or any other trade names, trademarks, service marks or logos;

(d) any refund, credit penalty payment, adjustment or reconciliation (i) related to real property taxes, personal property taxes or other Taxes paid prior to the Closing Date in respect of the Purchased Assets or relating to the Business or the Project, whether such refund, adjustment or reconciliation is received as a payment or as a credit against future Taxes payable, or (ii) arising under the Transferred Contracts and relating to any period before the Closing Date;

(e) the rights under any insurance policy arising out of and relating to events or periods prior to the Closing or which is not related to the Business or the Project, except to the extent such policy insures for events or occurrences that are included in the Assumed Liabilities;

(f) the contracts, leases and other agreements set forth on Schedule 2.2(f) and any other contracts, leases or other agreements of Seller or any other Person not used or useful in, or related primarily to or necessary for, the Business or the Project (the "*Excluded Contracts*");

(g) all books and records of Seller or any other Person other than the Books and Records;

(h) the rights and assets described in Schedule 2.2(h) as not part of the Purchased Assets (the "*Excluded Items*"); and

(i) the rights of Seller under this Agreement and the Ancillary Agreements.

2.3 *Assumed Liabilities*. On the Closing Date, Purchaser shall execute and deliver in favor of Seller the Assumption Agreement, pursuant to which Purchaser shall assume and agree to pay, perform and discharge when due the following Liabilities of Seller, whether direct or indirect, known or unknown (except as otherwise provided in **Section 11.1(c)** of this Agreement with respect to Environmental Liabilities and Tort Liabilities), absolute or contingent, accrued, fixed or otherwise, or whether due or to become due, solely to the extent such Liabilities accrue

or arise from and after the Closing (except as otherwise specifically provided in **Section 11.1(c)** of this Agreement with respect to Environmental Liabilities and Tort Liabilities), other than Excluded Liabilities (as defined below), in accordance with the respective terms and subject to the respective conditions thereof (collectively, but excluding the Excluded Liabilities, the "*Assumed Liabilities*"):

(a) all Liabilities of Seller under the Transferred Contracts, the Transferred Permits and the Transferred Intellectual Property, in each case in accordance with the terms thereof, except to the extent that such Liabilities, but for a breach or default by Seller, would have been paid, performed or otherwise discharged on or prior to the Closing Date or to the extent the same arise out of any such breach or default or out of any event which after the giving of notice would constitute a default by Seller;

(b) any and all Liabilities associated with Continued Employees, to the extent provided in **Section 6.5**;

(c) any Liability of Seller described on Schedule 2.3(c);

(d) any Liability for Real Property and other Taxes attributable to the Purchased Assets, except to the extent of the proration provided for in **Section 3.2**;

(e) subject to **Section 11.1(c)**, any and all Environmental Liabilities, except for the Excluded Environmental Liabilities; and

(f) subject to **Section 11.1(c)**, any and all Tort Liabilities, except for the Excluded Tort Liabilities.

2.4 ***Excluded Liabilities***. Except for the Assumed Liabilities, Purchaser shall not assume by virtue of this Agreement, the Assumption Agreement or any other Ancillary Agreement, or the transactions contemplated hereby or thereby, or otherwise, and shall have no liability for, any Liabilities of Seller (the "*Excluded Liabilities*"), including any of the following Liabilities:

(a) any Liabilities of Seller in respect of any Excluded Assets or other assets of Seller that are not Purchased Assets;

(b) any Liabilities in respect of Taxes attributable to the Purchased Assets for taxable periods ending on or before the Closing Date, except to the extent of the proration provided for in **Section 3.2**;

(c) any Liabilities of Seller (i) arising from the violation, breach or default by Seller, prior to the Closing Date, of any Transferred Contract, Transferred Permit or Transferred Intellectual Property or (ii) in respect of any other contract, agreement, personal property lease, permit, license or other arrangement or instrument entered into by Seller;

(d) subject to **Section 3.2**, any payment obligations of Seller, including accounts or notes payable, accruing or arising prior to the Closing Date;

(e) any fines and penalties imposed by any Governmental Authority resulting from any act or omission by Seller or its Affiliates that occurred prior to the Closing Date;

(f) any income Taxes attributable to income received by Seller;

(g) any Liability of Seller arising as a result of its execution and delivery of this Agreement or any Ancillary Agreement, the performance of its obligations hereunder or thereunder, or the consummation by Seller of the transactions contemplated hereby or thereby;

(h) any Liability of Seller based on Seller's acts or omissions after the Closing;

(i) any and all Environmental Liabilities to the extent accruing, arising or occurring during the period of Seller's (or any of its Affiliates') ownership of the Real Property or operation of the Project, and any and all other Environmental Liabilities to the extent accruing, arising or occurring prior to the Closing and within Seller's Knowledge prior to the Closing (the "***Excluded Environmental Liabilities***"); and

(j) any and all Tort Liabilities to the extent accruing, arising or occurring during the period of Seller's (or any of its Affiliates') ownership of the Real Property or operation of the Project, and any and all other Tort Liabilities to the extent accruing, arising or occurring prior to the Closing and within Seller's Knowledge prior to the Closing (the "***Excluded Tort Liabilities***").

ARTICLE III

PURCHASE PRICE; CLOSING

3.1 *Purchase Price*. At the Closing, Purchaser agrees to pay to Seller the sum of One Hundred Eighty-Nine Million Five Hundred Thousand and No/100 Dollars ($189,500,000.00), subject to adjustment pursuant to **Section 3.7** and **Section 10.1(g)** (the "***Purchase Price***").

3.2 *Proration*.

(a) Purchaser and Seller agree that, except as otherwise set forth in this Agreement, all of the items normally prorated, including those listed below, relating to the Business and the Purchased Assets shall be prorated as of the effective time of the Closing on the Closing Date, with Seller liable to the extent such items relate to any time period through the effective time of the Closing on the Closing Date, and Purchaser liable to the extent such items relate to any time period subsequent to the effective time of the Closing on the Closing Date:

(i) any rent, Taxes and other items payable by or to Seller under any of the Transferred Contracts to be assigned to and assumed by Purchaser hereunder;

(ii) any permit, license or registration fees with respect to any Transferred Permit; and

(iii) charges for water, telephone, electricity and other utilities.

(b) Purchaser and Seller agree that Property Taxes with respect to the Business or the ownership and the operations of the Purchased Assets or the Project shall be prorated as follows:

(i) Seller shall be liable for and shall pay when due all Property Taxes having a lien date in the year before the calendar year of the Closing Date.

(ii) Seller shall be liable for and shall pay when due all Property Taxes having a lien date in the same calendar year as the Closing Date; and

(iii) Property Taxes having a lien date in the calendar year following the year of the Closing Date shall be paid by Purchaser; however, such Property Taxes shall be prorated with (A) Seller being liable for that portion of the Property Taxes calculated by multiplying (1) the final determined Property Tax liability by (2) the number of days beginning with January 1 in the year of Closing up to and including the Closing Date divided by three hundred sixty-five (365) days, and (B) Purchaser being liable for that portion of the Property Taxes calculated by multiplying (1) the final determined Property Tax liability by (2) the number of days after the Closing Date up to and including December 31 in the year of Closing divided by three hundred sixty-five (365) days. Schedule 3.2(b) illustrates the operation of this **Section 3.2(b)**. After each payment of Property Taxes referred to in this **Section 3.2(b)(iii)** by Purchaser, Purchaser shall notify Seller in writing of the total amount of Property Taxes paid and, as to that payment, the prorated amount for which Seller is liable. Seller shall reimburse Purchaser such prorated amount within fifteen (15) days after receipt of the notice from Purchaser.

(c) In the event that actual figures are not available at the Closing Date, prorations required by **Section 3.2(a)** shall be calculated as follows:

(i) Such proration shall be based upon the actual fee, cost or amount of the specific item for the most recent preceding year (or appropriate period) for which an actual fee, cost or amount paid is available.

(ii) Upon the request of either Seller or Purchaser, made within sixty (60) days of the date that any actual amount previously estimated in accordance with **Section 3.2(c)(i)** becomes available (the "***Request Date***"), the Parties shall (A) calculate the prorated amounts using the actual available amounts (the "***Actual Prorated Amounts***"), (B) calculate the difference between the originally estimated prorations (the "***Estimated Prorated Amounts***") and the Actual Prorated Amounts (the "***Prorated Difference***"), and (C) the Party that at Closing paid less than the Actual Prorated Amount due from such Party based upon the Estimated Prorated Amounts shall pay the Prorated Difference to the other Party within sixty (60) days of the Request Date.

3.3 *Closing*. The Closing shall take place in Phoenix at the offices of Moyes Storey at 10:00 A.M. Phoenix time, on the third Business Day after the conditions to Closing set forth in **Articles VIII** and **IX** (other than actions to be taken or items to be delivered at Closing) have been either satisfied or waived by the Party entitled to waive such conditions, or on such other date and at such other time and place as Purchaser and Seller mutually agree in writing. All actions scheduled in this Agreement for the Closing Date shall be deemed to occur simultaneously at the Closing. Subject to the provisions of **Article X**, failure to consummate the purchase and sale provided for in this Agreement on the date determined pursuant to this **Section 3.3** will not result in the termination of this Agreement and will not relieve any Party of any obligation under this Agreement. The Closing shall be effective for all purposes as of 11:59:59 P.M. Phoenix time on the Closing Date.

3.4 ***Closing Deliveries by Seller to Purchaser***. At the Closing (or, in the case of clause (j) below, simultaneously with the execution and delivery hereof), Seller shall deliver, or shall cause to be delivered, to Purchaser the following:

(a) the Deed, duly executed by and acknowledged on behalf of Seller and in recordable form;

(b) the Bill of Sale and Assignment of Rights, duly executed by Seller;

(c) the Affidavit of Property Value, duly executed by and acknowledged on behalf of Seller;

(d) the FIRPTA Affidavit, duly executed by and acknowledged on behalf of Seller;

(e) a certificate of an officer of Seller, dated as of the Closing Date, setting forth and attesting to (i) the resolutions of the board of directors of the sole member of Seller authorizing the execution, delivery and performance of this Agreement and the Ancillary Agreements and the consummation of the transactions contemplated hereby and thereby, (ii) the incumbency and signature of the officer(s) of Seller executing this Agreement and the Ancillary Agreements and (iii) the Original Cost and the Accumulated Provision for Depreciation and Amortization for the Purchased Assets as of the Closing Date;

(f) a certificate of an officer of Seller, dated as of the Closing Date, as to the matters set forth in **Sections 8.1** and **8.2**;

(g) a complete copy of the certificate of formation (and all amendments thereto) of Seller, certified by the Secretary of State of Delaware as of a date not more than five (5) Business Days prior to the Closing Date, and a complete copy of the Charter Documents (and all amendments thereto) of Seller as in effect on the Closing Date, certified by an officer of Seller;

(h) certificates from appropriate Governmental Authorities, dated no earlier than five (5) Business Days prior to the Closing Date, as to the good standing and legal existence of Seller in the State of Delaware and as to the good standing and qualification to do business by Seller in the State of Arizona;

(i) the consents, waivers, authorizations and approvals set forth on Schedules 4.3(b) and 4.3(c), in form and substance reasonably satisfactory to Purchaser;

(j) a duly executed unconditional guaranty of Seller's obligations under Article X, Article XI and Section 12.15 in the form attached hereto as Exhibit F (the "*Guaranty Agreement*") from PPL Energy Supply;

(k) a tax clearance certificate from the Arizona Department of Revenue, dated no earlier than five (5) Business Days prior to the Closing Date, with respect to Seller; and

(l) such other documents as Purchaser may reasonably request to carry out the purposes of this Agreement.

3.5 *Closing Deliveries by Purchaser to Seller.* At the Closing, Purchaser shall deliver to Seller the following:

(a) a wire transfer of immediately available funds (to such account as Seller shall have notified Purchaser of at least two (2) Business Days prior to the Closing Date) in the amount equal to the Purchase Price (plus or minus any prorated amounts calculated pursuant to Section 3.2(c));

(b) the Affidavit of Property Value, duly executed by and acknowledged on behalf of Purchaser;

(c) an assumption agreement (the "*Assumption Agreement*"), in the form attached hereto as Exhibit A, evidencing the assumption by Purchaser of the Assumed Liabilities, duly executed by Purchaser;

(d) a certificate of an officer of Purchaser, dated as of the Closing Date, setting forth and attesting to (i) the resolutions of the board of directors of Purchaser authorizing the execution, delivery and performance of this Agreement and the Ancillary Agreements to which it is a party and the consummation of the transactions contemplated hereby and thereby, and (ii) the incumbency and signature of each officer of Purchaser executing this Agreement and the Ancillary Agreements to which it is a party;

(e) a certificate of an officer of Purchaser, dated as of the Closing Date, as to the matters set forth in Sections 9.1 and 9.2;

(f) a complete copy of Purchaser's articles of incorporation (and all amendments thereto), certified by the ACC as of a date not more than five (5) Business Days prior to the Closing Date, and a complete copy of the bylaws (and all amendments thereto) of Purchaser, certified by an officer of Purchaser;

(g) a certificate from the ACC, dated no earlier than five (5) Business Days prior to the Closing Date, as to the good standing and legal existence of Purchaser in Arizona; and

(h) such other documents as Seller may reasonably request to carry out the purposes of this Agreement.

3.6 *Allocation of Purchase Price.*

(a) Seller and Purchaser agree that prior to the Closing, the Purchase Price shall be allocated among the Purchased Assets in accordance with an allocation schedule (the "*Purchase Price Allocation Schedule*") agreed upon by Purchaser and Seller, which shall be prepared in a manner required by Section 1060 of the Code and any other applicable Law and delivered by Purchaser to Seller prior to the Closing. Seller and Purchaser each shall prepare a mutually acceptable and substantially identical IRS Form 8594 "Asset Acquisition Statements Under Section 1060" consistent with the Purchase Price Allocation Schedule which the Parties shall use to report the transactions contemplated by this Agreement to the applicable Taxing Authorities. Each of Seller and Purchaser agrees to provide the other promptly with any other information required to complete IRS Form 8594. Each Party agrees that it shall not, without the consent of the other Party, take a position on any Tax Return, or before any Taxing Authority in connection with the examination of any Tax Return or in any subsequent judicial proceeding, that is in any manner inconsistent with the terms of the Purchase Price Allocation Schedule. In recognition of Seller's status as a disregarded entity for U.S. federal and Arizona income tax purposes, Purchaser agrees that Seller's responsibilities and obligations under this **Section 3.6(a)** shall be satisfied by Seller cooperating with its sole member with respect to such responsibilities and obligations.

(b) If Purchaser and Seller are unable to agree upon the Purchase Price Allocation Schedule within fifteen (15) days prior to the scheduled Closing Date, Purchaser and Seller shall refer the matter to Independent Accountants, which shall determine the Purchase Price Allocation Schedule (including any valuations) in accordance with the provisions set forth in this **Section 3.6(b)**. The Independent Accountants shall be instructed to deliver to Purchaser and Seller a written determination of the Purchase Price Allocation Schedule within ten (10) days from the date of referral thereof to the Independent Accountants. For purposes of this **Section 3.6(b)** and whenever the Independent Accountants are retained to resolve a dispute between the Parties under this Agreement, the Independent Accountants may determine the issues in dispute following such procedures, consistent with the provisions of this Agreement, as they deem appropriate in the circumstances and with reference to the amounts in issue. The Parties do not intend to impose any particular procedures upon the Independent Accountants, it being the desire of the Parties that any such disagreement shall be resolved as expeditiously and inexpensively as reasonably practicable. The Independent Accountants shall have no liability to the Parties in connection with such services except for acts of bad faith, willful misconduct or gross negligence, and the Parties shall provide such indemnities to the Independent Accountants as they may reasonably request. Except in the case of fraud or manifest error, the finding of the Independent Accountants shall be final and binding on the Parties. Purchaser and Seller shall share equally the fees and disbursements of the Independent Accountants in connection with resolving the dispute.

3.7 *Minimum Inventory Amount Adjustment.*

(a) The Purchase Price will be increased on a dollar-for-dollar basis to the extent that the Post-Closing Inventory Amount Determination (as defined below) is greater than the Minimum Inventory Amount (provided that such increase shall in no event exceed $100,000) and decreased on a dollar-for-dollar basis to the extent that the Post-Closing Inventory Amount Determination is less than the Minimum Inventory Amount.

(b) At least five (5) Business Days prior to the execution and delivery hereof, Seller shall have provided Purchaser with a certificate containing a description, part number, quantity on hand, average unit cost and extended value (quantity times average unit cost) with respect to each class of inventory as of the last day of each calendar month between January 1, 2003 and December 31, 2003. During the Interim Period, Purchaser will be entitled to conduct onsite test counts of the spare parts inventory in accordance with **Section 6.2**.

(c) Within sixty (60) days after the Closing Date, Purchaser will deliver to Seller written notice (the "***Inventory Adjustment Notice***") of Purchaser's post-Closing determination of the spare parts in inventory as of the Closing Date (the "***Post-Closing Inventory Amount Determination***"), as derived from Purchaser's physical review of the spare parts in inventory, the records (financial and otherwise) relating to such spare parts, and the Transferred Contracts. The Inventory Adjustment Notice will contain reasonable detail as to how the Post-Closing Inventory Amount Determination was determined by Purchaser. Within twenty (20) days after Seller's receipt of the Inventory Adjustment Notice, Seller will notify Purchaser in writing of Seller's acceptance or rejection of the Post-Closing Inventory Amount Determination as set forth in the Inventory Adjustment Notice. Any notice of rejection by Seller must include the reasons for such rejection and, if appropriate, Seller's proposed calculation of the Post-Closing Inventory Amount Determination. If (i) by written notice to Purchaser, Seller accepts the Post-Closing Inventory Amount Determination as set forth in the Inventory Adjustment Notice, or (ii) Seller fails to deliver any notice of acceptance or rejection of the Post-Closing Inventory Amount Determination within the prescribed twenty (20)-day period (which failure will result in Seller being deemed to have irrevocably accepted and agreed with the Post-Closing Inventory Amount Determination), the Post-Closing Inventory Amount Determination as set forth in the Inventory Adjustment Notice will be final and binding on the Parties.

3.8 *Adjustment Disputes.*

(a) If Seller delivers written notice to Purchaser under **Section 3.7(c)** of rejection of the Post-Closing Inventory Amount Determination as set forth in the Inventory Adjustment Notice, Seller and Purchaser will promptly (and in any event within ten (10) Business Days after the date of delivery of Seller's notice of rejection to Purchaser) cause their respective representatives to confer with each other with a view to resolving any such matter. If such Parties' representatives are unable to resolve any such matter within thirty (30) days after the date of delivery of Seller's notice of rejection to Purchaser, Seller and Purchaser will refer the dispute to Independent Accountants for review and final determination of the Post-Closing Inventory Amount Determination. The Independent Accountants shall be instructed to deliver to Purchaser and Seller a written determination of the Post-Closing Inventory Amount Determination within ten (10) Business Days from the date of referral thereof to the Independent

Accountants. The Independent Accountants may request of Seller or Purchaser such documents and information as may be necessary or appropriate for proper determination of any such matter, and such Parties will cooperate to promptly satisfy any such request. Except in the case of fraud or manifest error ,the determination by the Independent Accountants of the Post-Closing Inventory Amount Determination will be final and binding on the Parties. Seller and Purchaser will equally share the fees and disbursements of the Independent Accountants in undertaking such review and determination.

(b) Within five (5) Business Days after the final agreement of Seller and Purchaser, the final determination by the Independent Accountants or the deemed acceptance by Seller (as the case may be) of the Post-Closing Inventory Amount Determination, either:

(i) Purchaser will pay to Seller, by wire transfer of immediately available funds, the amount (if any) by which the Post-Closing Inventory Amount Determination exceeds the Minimum Inventory Amount (provided that such adjustment shall in no event exceed $100,000), or

(ii) Seller will pay to Purchaser, by wire transfer of immediately available funds, the amount (if any) by which the Post-Closing Inventory Amount Determination is less than the Minimum Inventory Amount.

3.9 ***Change in Name***. Not more than ten (10) Business Days after the Closing Date, Purchaser shall remove all signs or other indications of ownership at the Project or on the Purchased Assets that reference Seller.

ARTICLE IV

REPRESENTATIONS AND WARRANTIES OF SELLER

The representations and warranties contained in this **Article IV** are qualified by the disclosure made with respect to such representations and warranties in the Schedules attached hereto, to the extent that such disclosure specifically identifies, or that it is reasonably apparent that such disclosure relates to, the subsections that it qualifies. This **Article IV** and the Schedules shall be read together as an integrated provision. Subject to the foregoing, effective as of the Agreement Date and the Closing Date, Seller hereby represents and warrants to Purchaser that, except as disclosed in the Schedules:

4.1 ***Organization, Standing and Power***. Seller is a limited liability company duly formed, validly existing and in good standing under the Laws of Delaware and has all requisite power and authority to conduct its business as it is now being conducted and to own, lease and operate the Business and the Purchased Assets. Seller is duly qualified or licensed to do business in each jurisdiction in which the ownership or operation of the Purchased Assets or the nature of the business conducted by it make such qualification or licensing necessary, except in those jurisdictions where the failure to be so qualified or licensed would not reasonably be expected to result in a material adverse effect on Seller's ability to perform its obligations hereunder. Seller has made available to Purchaser true, correct and complete copies of Seller's Charter Documents.

4.2 *Authority*. Seller has all requisite limited liability company power and authority to execute and deliver this Agreement and each of the Ancillary Agreements to which it is a party, to perform its obligations hereunder and thereunder and to consummate the transactions contemplated hereby and thereby. The execution and delivery by Seller of this Agreement and each Ancillary Agreement to which Seller is a party, and the performance by Seller of its obligations hereunder and thereunder, have been duly and validly authorized by all necessary limited liability company action. This Agreement and each of the Ancillary Agreements to which Seller is a party have been duly and validly executed and delivered by Seller and constitute the legal, valid and binding obligation of Seller enforceable against Seller in accordance with their respective terms, except that the enforcement hereof and thereof may be limited by bankruptcy, insolvency, reorganization, arrangement, moratorium or other similar Laws relating to or affecting the rights of creditors generally, or by general equitable principles.

4.3 *No Conflicts*. The execution, delivery and performance by Seller of this Agreement and each of the Ancillary Agreements to which Seller is a party and the completion of the transactions contemplated hereby and thereby do not and will not:

(a) conflict with or result in a violation or breach of any of the terms, conditions or provisions of the Charter Documents of Seller;

(b) assuming the notices, consents and waivers set forth on Schedule 4.3(b) (the "*Seller Consents*") have been made or obtained:

(i) violate, result in a breach of, constitute (with due notice or lapse of time or both) a default or cause any obligation, penalty, premium or right of termination, cancellation or acceleration to arise or accrue under, any Contract to which Seller is a party or by which it or any of the Purchased Assets may be bound, except for any such defaults or consents (or rights of termination, cancellation or acceleration) as to which requisite waivers or consents have been obtained or which would not, individually or in the aggregate, reasonably be expected to have a Seller Material Adverse Effect;

(ii) result in the creation or imposition of any Lien upon any of the Purchased Assets;

(iii) result in the cancellation, modification (except as contemplated by this Agreement), revocation or suspension of any Transferred Contract, Transferred Permit or Transferred Intellectual Property;

(iv) require the consent, approval, or notification of, or registration or filing with, any third party; or

(v) cause Purchaser, any of its Affiliates, or any of the Purchased Assets to become subject to, or liable for the payment of, any Tax relating to the operation of Seller, the Purchased Assets or the Business for any period ending or deemed to end on or before the Closing Date; and

(c) assuming all required filings, approvals, consents, authorizations and notices set forth on Schedule 4.3(c) (collectively, the "*Seller Approvals*") have been made, obtained or given, (i) conflict with or result in a violation or breach of any term or provision of any Law or writ, judgment, order or decree applicable to Seller or its Assets, or (ii) require the consent, approval, or notification of, or registration or filing with, any Governmental Authority under any applicable Law.

4.4 *Business*. The Business is the only business operation carried on by Seller. Except for the Excluded Items, the Purchased Assets are sufficient to operate the Business as currently operated and constitute all the assets and rights that are used by Seller or any of its Affiliates in connection with the operation of the Business. All equipment included in the Purchased Assets (other than spare parts and other equipment not currently in service) and all buildings, structures and fixtures constituting part of the Project have been maintained by Seller in accordance with Good Operating Practices, except for ordinary wear and tear. There are no pending or, to Seller's Knowledge, threatened proceedings or governmental actions to condemn or take by power of eminent domain all or any part of the Purchased Assets. For purposes of this Agreement, "*Seller's Knowledge*" means the actual knowledge of the individuals named on Schedule 4.4, who Seller represents to be the persons generally responsible for the subject matters to which such knowledge is pertinent.

4.5 *Subsidiaries*. Seller does not have any subsidiaries or own equity interests in any Person.

4.6 *Legal Proceedings*.

(a) Neither Seller nor any of its Affiliates has been served with notice of any Claim, and, to Seller's Knowledge, none has been threatened against any such Person, that (i) affects Seller or the Purchased Assets and would, individually or in the aggregate, if pursued or resulting in a judgment against Seller, reasonably be expected to have a Seller Material Adverse Effect or (ii) seeks a writ, judgment, order or decree restraining, enjoining or otherwise prohibiting or making illegal any of the transactions contemplated by this Agreement. Seller does not have any Knowledge of any facts that would reasonably be expected to form the basis for any such Claim, writ, judgment, order or decree.

(b) Schedule 4.6(b) lists all of the currently pending legal proceedings before any Governmental Authority relating to the Project or the Business (but not, however, including any such legal proceedings that apply generically to the electric power industry or any segment thereof, or to participants within such industry or any such segment). To Seller's Knowledge, all currently effective filings relating to the Project or the Business heretofore made by Seller with any Governmental Authority were made in compliance with the Laws then applicable thereto and the information contained therein was true and correct in all material respects as of the respective dates of such filings.

4.7 *Compliance with Laws and Orders*. Seller is in compliance with all Laws and orders applicable to it, except where any such non-compliance would not, in the aggregate, reasonably be expected to have a Seller Material Adverse Effect; provided that this Section 4.7

does not address (a) Real Property, which is exclusively addressed by **Section 4.13**, or (b) Environmental Laws, which are exclusively addressed by **Sections 4.15** and **4.16**.

4.8 *Liabilities*. Except as disclosed on Schedule 4.8, Seller has no Liabilities that individually or in the aggregate exceed $100,000, excluding (i) Liabilities under the Transferred Contracts and Excluded Contracts, (ii) Liabilities under this Agreement, (iii) Liabilities under Seller's Permits listed on Schedule 4.15, (iv) Liabilities under this Agreement for which Seller is responsible, and (v) Liabilities incurred after the date hereof in accordance with the provisions contained in **Article VI**.

4.9 *Absence of Certain Changes or Events*. Except as set forth in Schedule 4.9, and except as otherwise contemplated by this Agreement, between December 31, 2003, and the Agreement Date, there has not been: (i) any Seller Material Adverse Effect; (ii) any damage, destruction or casualty loss, whether covered by insurance or not, which has had a Seller Material Adverse Effect; or (iii) any entry into any agreement, commitment or transaction (including any borrowing, capital expenditure or capital financing) by Seller or any of its Affiliates, which is material to the Business or operations of the Purchased Assets, except agreements, commitments or transactions in the ordinary course of business or as contemplated herein.

4.10 *Taxes*. All Tax Returns that are required to be filed on or before the Closing Date by, on behalf of or relating to Seller or its financial results have been or will be duly and timely filed or are the subject of a timely filed and valid extension. All Taxes that are shown to be due on such Tax Returns with respect to the Business have been or will be timely paid in full. All Property Taxes with respect to the Purchased Assets having a lien date in the year before the calendar year of the Closing Date have been or will be paid in full by Seller no later than the respective due dates for such Property Taxes. All Property Taxes with respect to the Purchased Assets having a lien date in the same year as the Closing Date have been or will be paid in full by Seller no later than the respective due dates for such Property Taxes. All Property Tax Returns with respect to the Purchased Assets have been or will be duly and timely filed by Seller for certain time periods, as set forth in **Section 7.1(b)**. All withholding Tax requirements imposed on Seller have been satisfied in full in all respects. Seller does not have in force any waiver of any statute of limitations in respect of Taxes or any extension of time with respect to a Tax assessment or deficiency. There are no pending or active audits or, to Seller's Knowledge, threatened audits or proposed deficiencies or other claims for unpaid Taxes of Seller.

4.11 *Regulatory Status*.

(a) Seller is qualified as an "exempt wholesale generator" and the Project is an "eligible facility," each within the meaning of Section 32(a) of the Public Utility Holding Company Act of 1935. Except as set forth on Schedule 4.11(a), Seller is not subject to regulation as a public utility or public service company (or similar designation) by the United States, any State of the United States, any foreign country or any municipality or any political subdivision of the foregoing.

(b) Seller is not an "investment company," a company "controlled" by an "investment company" or an "investment advisor" within the meaning of the Investment Company Act of 1940.

4.12 *Contracts.*

(a) Schedule 4.12(a) sets forth a complete and accurate list as of the Agreement Date of all of the following Transferred Contracts to which Seller or an Affiliate of Seller is a party relating to the Project or the Business or by which the Purchased Assets may be bound (collectively, "***Material Contracts***" and individually a "***Material Contract***"):

(i) Contracts for the future purchase, exchange or sale of gas;

(ii) Contracts for the future purchase, exchange or sale of power or ancillary services;

(iii) Contracts for the future purchase, exchange, or sale of steam;

(iv) Contracts for the future transportation or transmission of gas or electric power;

(v) interconnection Contracts;

(vi) Contracts (A) for the sale of any Asset or (B) that grant a right or option to purchase any Asset, other than Contracts entered into in the ordinary course of business relating to Assets with a value of less than $50,000 individually or $100,000 in the aggregate;

(vii) Contracts (other than Contracts identified pursuant to **Sections 4.12(a)(i) through (vi)**) for the future provision of goods or services and requiring payments by Seller in excess of $50,000 for each individual Contract;

(viii) Contracts under which Seller has created, incurred, assumed or guaranteed any outstanding indebtedness for borrowed money or any capitalized lease obligation, or under which Seller has imposed a security interest on any of its Assets, tangible or intangible, which security interest secures outstanding indebtedness for borrowed money;

(ix) outstanding agreements of guaranty, surety or indemnification, direct or indirect, by Seller, or by any Affiliate of Seller for the benefit of Seller;

(x) Contracts between Seller and any Affiliate of Seller relating to the future provision of goods or services by Seller to such Affiliate of Seller, or by such Affiliate of Seller to Seller;

(xi) Any contract for consulting that provides for annual compensation by Seller in an amount in excess of $50,000 and which is not cancelable by Seller on ninety (90) days or less advance notice;

(xii) outstanding futures, swap, collar, put, call, floor, cap, option or other Contracts that are intended to benefit from or reduce or eliminate the risk of fluctuations in the price of commodities, including electric power, gas or securities;

(xiii) Contracts that purport to limit Seller's freedom to compete in any line of business or in any geographic area;

(xiv) partnership, joint venture or limited liability company agreements; and

(xv) Contracts conveying, granting, leasing or assigning to or by Seller an interest in real property.

(b) Seller has provided Purchaser with, or access to, true and complete copies of all Material Contracts.

(c) Each of the Material Contracts is in full force and effect in all material respects and constitutes a valid and binding obligation of Seller (or, if applicable, an Affiliate of Seller) and, to Seller's Knowledge, of the other parties thereto, and, except as disclosed in Schedule 4.12(c), each Transferred Contract may be transferred to Purchaser pursuant to this Agreement without the consent of the other parties thereto and without breaching any material terms thereof or resulting in the forfeiture or impairment of any rights thereunder.

(d) Except as set forth in Schedule 4.12(d), there is not under any Material Contract any material default or event which, with notice or lapse of time or both, (i) would constitute a material default by Seller (or by any Affiliate of Seller which is a party thereto) or, to Seller's Knowledge, any other party thereto, (ii) would constitute a default by Seller (or by any Affiliate of Seller which is a party thereto) or, to Seller's Knowledge, any other party thereto which would give rise to an automatic termination, or the right of discretionary termination thereof, or (iii) would cause the acceleration of any of Seller's (or any of its Affiliates') obligations thereunder or result in the creation of any Lien (other than any Permitted Lien) on any of the Purchased Assets. There are no claims, actions, proceedings or investigations pending or, to Seller's Knowledge, threatened against Seller (or by any Affiliate of Seller which is a party thereto) or, to Seller's Knowledge, any other party to any Material Contract before any Governmental Authority acting in an adjudicative capacity, in each case relating in any way to any Material Contract or the subject matter thereof. Seller has no Knowledge of any defense, offset or counterclaim arising under any Material Contract.

(e) Schedule 4.12(e) details all warranties by any vendor, materialman, supplier, contractor or subcontractor relating to the Purchased Assets or any component thereof and specifies the following information with respect to each such warranty: (i) the item of equipment or other item of the Purchased Assets to which the warranty is applicable, but only to the extent such item has a value of $50,000 or more, (ii) the contract or agreement pursuant to which the warranty was given or made (a true and complete copy of each such contract or agreement has been provided to Purchaser); (iii) a description of any warranty work done under the applicable warranty, the date thereof and the applicable warranty period for the warranty

work; and (iv) whether such warranty is transferable to Purchaser. Except as disclosed on Schedule 4.12(e), Seller has complied with all storage, installation, operation, maintenance and other requirements with respect to each item of equipment or other item of the Purchased Assets to which each warranty relates and each other condition to the continued effectiveness of each such warranty, and there are no events that have occurred or conditions applicable that constitute or may constitute a defense to the continuing effectiveness of each such warranty.

4.13 *Real Property*.

(a) Transferred Real Property. Schedule 4.13(a) contains a true and complete list of all Real Property of Seller that is part of the Purchased Assets (including all rights of Seller relating to any rights of way, encumbrances or other such rights). Based solely upon the Existing Title Policies, Seller owns or leases (as tenant or lessee) all Real Property listed on Schedule 4.13(a), in each case free and clear of all Liens (except for Permitted Liens that do not affect the use or marketability of such Real Property) created by, through or under Seller, except as otherwise noted on Schedule 4.13(a) or as disclosed or listed in the Existing Title Policies, true and complete copies of which title policies have been made available for due diligence review by Purchaser.

(b) Encumbrances and Improvements. Schedule 4.13(b) includes a description of all encumbrances, easements, licenses or rights of way of record (or, if not of record, of which Seller has Knowledge) granted on or appurtenant to or otherwise affecting the Real Property, and all plants, buildings, structures or other Improvements located thereon. All Liens, easements or rights of way that are not of public record, if any, would not reasonably be expected to have a Seller Material Adverse Effect. There are now in full force and effect duly issued certificates of occupancy permitting the Real Property and Improvements located thereon to be legally used and occupied as the same are now constituted. To Seller's Knowledge, and except for any items listed in the Existing Title Policies or the survey prepared by Superior Surveying Services, Inc., dated July 29, 2002 under Job #220649 (the "***Existing Survey***"): (i) no fact or condition exists which would prohibit or adversely affect the ordinary rights of access to and from the Real Property from and to the existing highways and roads; (ii) there is no pending or threatened restriction or denial, governmental or otherwise, upon such ingress and egress; (iii) there is not (A) any claim of adverse possession or prescriptive rights involving any of the Real Property, (B) any structure located on any Real Property which encroaches on or over the boundaries of neighboring or adjacent properties or (C) any structure of any other party which encroaches on or over the boundaries of any such Real Property; and (iv) no public improvements have been commenced and none are planned which in either case may result in special assessments or otherwise would, individually or in the aggregate, reasonably be expected to have a Seller Material Adverse Effect.

(c) Real Property Leases. Except as set forth in Schedule 4.13(c), there are no real property leases, recorded or unrecorded (the "***Real Property Leases***"), relating to the Purchased Assets under which Seller is a lessee, lessor or under which Seller has any interest.

(d) Approval. No state, municipal, or other governmental approval regarding the division, platting, or mapping of real estate is required as a prerequisite to the conveyance by

Seller to Purchaser (or as a prerequisite to the recording of any conveyance document) of any Real Property pursuant to the terms hereof.

(e) Governmental Restrictions: Condemnation. Seller has not received, and does not have Knowledge of, any notifications, restrictions, or stipulations from the United States of America, the State of Arizona, the County of Pinal, or any other Governmental Authority requiring any work to be done on the Real Property or threatening the use of the Real Property. There are no pending or, to Seller's Knowledge, threatened taking or condemnation proceedings affecting any portion of the Real Property. Seller is not subject to, and, to Seller's Knowledge, no basis exists for, any order, judgment, decree or governmental restriction that would adversely affect the transactions contemplated by this Agreement, the Real Property or the use of the Real Property in the manner presently being used by Seller. Seller has no Knowledge of any plan, study, litigation, action, proceeding or effort by any Governmental Authority or private party which in any way challenges, affects or would challenge or affect the continuation of the present use of the Real Property specifically.

(f) Title and Access. Based solely upon the Existing Title Policies, fee simple title to the Real Property is currently vested in Seller. Permanent, legal access as presently existing is available to the Real Property from a dedicated public right-of-way.

(g) Knowledge of Adverse Title Matters. Except as set forth on Schedule 4.13(g), Seller has no Knowledge of any title defect, Lien, encumbrance, adverse claim, or other matter relating to the title to the Real Property or to the title insurance coverage for the Real Property which is not shown by the public records, the Existing Title Policies or the Existing Survey.

(h) Absence of Liens. No Liens against the Real Property are pending, or to Seller's Knowledge, are threatened or have arisen or exist under federal or state Tax Law, any Environmental Law, or other applicable federal or state Law, other than Permitted Liens.

(i) Utilities. All water, sewer, telephone, gas and electrical facilities that are presently installed to the Real Property line, are, to Seller's Knowledge, available and in good working order, and, to Seller's Knowledge, are in compliance with all applicable Laws of all Governmental Authorities having jurisdiction and with the rules and regulations of the relevant public utilities.

(j) Zoning. The Real Property is zoned in part Industrial (CI-2), subject to an Industrial Use Permit for a natural gas electrical peaking power generation facility (including the stipulations listed in such permit), and in part General Rural Zone (GR).

(k) Condition of Property. To Seller's Knowledge, except as set forth on Schedule 4.13(k), all of the improvements, buildings and fixtures on or part of the Real Property were constructed in a good and workmanlike manner, are structurally sound, and, for purposes of their use in the Business as currently conducted, are in good and proper working condition and repair, normal wear and tear excepted.

(l) Insurance. Seller has not received any written (or, to Seller's Knowledge, any oral) notice from any insurance company of any defects or any inadequacies in the Real

Property or any part thereof that would adversely affect the insurability of the Real Property. To Seller's Knowledge, the Real Property is in compliance with the material requirements of all insurance carriers currently providing insurance for the Real Property.

(m) Compliance. Seller has complied, in all material respects, with all Laws, and all requirements and orders of Governmental Authorities, with respect to the Real Property and the operations presently being conducted by Seller upon the Real Property. Neither the Real Property, nor any improvement or building upon the Real Property, nor the continued maintenance or use of any portion of the Real Property for the Business, nor the current operations being conducted by Seller on the Real Property, violates, in any material respect, any such Laws, requirements and orders, including zoning or building Laws, ordinances, orders or regulations. Seller has obtained all material Permits currently required for the conduct of the current operations on the Real Property, all such Permits are in full force and effect, and Seller is, in all material respects, in compliance therewith. Notwithstanding any of the foregoing, this **Section 4.13** does not address Environmental Laws, which are exclusively addressed by **Sections 4.15** and **4.16**.

(n) Archeological Artifacts and Endangered Species. To Seller's Knowledge, there are no historical or archeological materials or artifacts of any kind or any Indian ruins of any kind located on the Real Property. To Seller's Knowledge, no part of the Real Property is "critical habitat" as defined in the Federal Endangered Species Act, 16 U.S.C. §§ 1531 *et seq.*, or in regulations promulgated thereunder, nor are any "endangered species" or "threatened species" located on the Real Property, as defined therein.

(o) Americans with Disabilities Act. Seller has not received any written (or to Seller's Knowledge, any oral) notice of violation of, and the Real Property is in compliance in all material respects with, the Americans with Disabilities Act of 1990.

(p) Special Districts. To Seller's Knowledge, except as set forth in Schedule 4.13(p), the Real Property is not located within any water conservation, irrigation, soil conservation, weed or insect abatement, or other similar district, or any special improvement district. To Seller's Knowledge, except as shown on the Survey, the Real Property is not within a flood plain, flood way or flood control district.

(q) Taxes. To Seller's Knowledge, Seller does not have any liability for any Taxes, or any interest or penalty in respect thereof, of any nature that may be assessed against Purchaser or that are or may become a Lien against the Real Property, other than the lien for current real property Taxes not yet due and payable.

(r) Mechanics' Liens. Except as described in Schedule 4.13(r), no work has been performed on or about the Real Property within six (6) months prior to the Agreement Date that would legally entitle any Person to file or record any mechanics' or materialmen's Liens.

(s) Water Rights.

(i) Seller holds all water rights appurtenant to the Property, including those certificated rights identified on Schedule 4.13(s)(i) attached hereto (collectively, the "***Water Rights***").

(ii) Seller owns the wells ("***Wells***") and well sites further identified on Schedule 4.13(s)(ii).

(iii) To Seller's Knowledge, the Water Rights remain appurtenant to the Real Property, and no Water Rights have been severed from that portion of the Real Property to which they are appurtenant.

(iv) To Seller's Knowledge, to the extent that either Seller or Marcus D. Martin Farms, pursuant to that certain Lease Agreement by and between Marcus D. Martin d/b/a Marcus D. Martin Farms and Seller dated December 12, 2001 (the "***Martin Farms Lease***"), has used any groundwater at or for the Real Property, all such groundwater has been pumped pursuant to a Certificate of Grandfathered Groundwater Right (a "***Water Rights Certificate***") issued by the Arizona Department of Water Resources (the "***DWR***") solely for the purposes permitted by applicable Law pursuant to such Certificate in such a manner that the Water Rights are not subject to claims of abandonment or forfeiture.

(v) All filings, registrations and assessments for the Water Rights appurtenant to the Real Property have been made and are current with all appropriate Governmental Authorities, including the DWR. As used herein, the phrase, "filings, registrations and assessments" includes registrations of Wells and all notifications of change of ownership forms necessary to assign, transfer or otherwise convey the reported ownership of the Water Rights and Wells from any previous owner to the Seller.

(vi) To Seller's Knowledge, as of the date hereof, there are no charges, pump Taxes, groundwater withdrawal and use fees or assessments due or owing to any state agency including DWR for the Water Rights.

(vii) As of the date hereof, there are no enforcement actions by DWR threatened or pending against Seller relating to the Water Rights, and to Seller's Knowledge, Seller is in material compliance with all water conservation rules, regulations and requirements as set forth in the applicable management plans for the Pinal County active management area.

(viii) Seller has caused Annual Groundwater Withdrawal and Use Reports to be prepared and filed annually with DWR for each Water Right, pursuant to the rules and regulations promulgated by DWR.

4.14 *Personal Property*. Seller has good title to (or, with respect to those items of tangible personal property held pursuant to a lease, a good and valid leasehold interest in) all of its tangible personal property, including the tangible personal property listed on Schedule 4.14,

free and clear of all Liens, except for Permitted Liens. The foregoing shall not apply with respect to any item of Intellectual Property, which is governed exclusively by **Section 4.18**. Seller has good title, free and clear of Liens (other than Permitted Liens), to the spare parts in inventory listed or disclosed on Schedule 4.14.

4.15 *Permits*.

(a) Seller has obtained all material Permits required for the ownership and operation of the Project by Seller in the manner in which it is currently owned and operated. All such Permits are set forth on Schedule 4.15, are in full force and effect, and have not been amended except as set forth on Schedule 4.15 or for extensions in the ordinary course of business.

(b) Seller is in compliance, in all material respects, with all Permits set forth on Schedule 4.15, and, except as set forth on Schedules 4.6(b) and 4.16(b), Seller has not received any written notification from any Governmental Authority alleging that it is in violation of any such Permits.

4.16 ***Environmental Matters.***

(a) Seller has made available to Purchaser, on a confidential basis in accordance with the terms and conditions of **Section 12.5**, true and complete copies of all environmental site assessment reports, studies and related documents in the possession of, or available to, Seller or its Affiliates and that relate to environmental matters in connection with the operation of the Project or the Real Property.

(b) Except as set forth on Schedule 4.16(b):

(i) Seller has not been served with notice of any Environmental Claims and, to Seller's Knowledge, no Environmental Claims are threatened against Seller by any Governmental Authority or other Person (including any private citizen's group) under any Environmental Laws;

(ii) there has been no event or occurrence at the Project that has caused or reasonably would be expected to cause Seller to fail to comply with any applicable Environmental Laws in any material respect;

(iii) there has been no Release of any Hazardous Material at or from the Project that could reasonably be expected to result in an Environmental Claim;

(iv) there are not outstanding, nor have there been issued, any judgments, decrees or judicial orders relating to the Purchased Assets regarding (A) compliance with any Environmental Law or (B) the investigation or cleanup of Hazardous Materials under any Environmental Law;

(v) Seller is, and at all times has been, in compliance with, in all material respects, and has not been and is not in violation of or liable in any

material respect under, any Environmental Law in connection with the Business or the Purchased Assets;

(vi) to Seller's Knowledge, there are no Environmental Liabilities associated with the Purchased Assets that would, individually or in the aggregate, reasonably be expected to have a Seller Material Adverse Effect; and

(vii) Seller is and at all times has been in full compliance with all terms and conditions of the Certificate of Environmental Compatibility.

(c) Seller makes no representation or warranty regarding any environmental matters except as expressly set forth in **Sections 4.15** and **4.16**.

4.17 *Insurance*. The Project and its tangible Assets are covered by insurance policies in such amounts and against such risks and losses as are consistent with Seller's historical practices. To Seller's Knowledge, except as set forth in Schedule 4.17, all such policies purchased or held by and insuring the Business or the Purchased Assets are in full force and effect, and all premiums with respect thereto covering all periods up to and including the date as of which this representation is being made have been paid. Seller has not received any written (or to Seller's Knowledge, any oral) notice of cancellation or termination with respect to any such policy which was not replaced on substantially similar terms prior to the date of such cancellation. Seller has provided to Purchaser a summary of the loss experience under each insurance policy insuring the Business or the Purchased Assets. Except as described in Schedule 4.17, Seller has not been refused any insurance with respect to the Business or the Purchased Assets nor, to Seller's Knowledge, has Seller's coverage been limited by any insurance carrier to which it has applied for any such insurance or with which it has carried insurance during the twelve (12) month period immediately preceding the Agreement Date.

4.18 *Intellectual Property*. Except for the Excluded Items:

(a) Schedule 4.18 lists all issued patents and registered trademarks owned by Seller and currently used in the United States in the Business as currently conducted. As described on Schedule 4.18, Seller owns, or has the license or right to use for the Business, all material Intellectual Property currently used in the Business. The Parties acknowledge and agree that Purchaser shall not acquire in or in connection with the transactions contemplated by this Agreement or any of the Ancillary Agreements any trademarks or trade names using "PPL."

(b) Seller has not received from any third party a claim in writing that Seller is infringing the Intellectual Property of such third party. To Seller's Knowledge, no third party is infringing any Intellectual Property owned or exclusively licensed by Seller.

4.19 *Related Persons*. Except as set forth on Schedule 4.19, no Affiliate of Seller has any interest in any of the Purchased Assets, and no Affiliate of Seller is a party to any Contract with Seller with respect to the Purchased Assets.

4.20 *Brokers*. Seller does not have any liability or obligation to pay fees or commissions to any broker, finder or agent with respect to the transactions contemplated by this Agreement for which Purchaser could become liable or obligated.

4.21 *Employees*.

(a) Each of the employees at the Project (each, a "*Project Employee*") is employed by PPL Montana. Schedule 4.21(a) sets forth, with respect to each Project Employee (including any Project Employee who is on a leave of absence or on layoff status): (i) the name and title of such Project Employee; (ii) the aggregate dollar amounts of the compensation (including wages, salary, commissions, fringe benefits, bonuses, profit-sharing payments and other payments or benefits of any type) received by such Project Employee from PPL Montana; (iii) such Project Employee's annualized compensation as of the Agreement Date; (iv) the number of hours of sick-time which such Project Employee has accrued as of the date hereof and the aggregate dollar amount thereof; and (v) the number of hours of vacation time which such Project Employee has accrued as of the date hereof and the aggregate dollar amount thereof.

(b) Except as set forth on Schedule 4.21(b), neither PPL Montana nor Seller is a party to or bound by, or has ever been a party to or bound by, any employment contract or any union contract, collective bargaining agreement or similar contract with respect to the Project. The employment of the Project Employees is terminable by Seller at will and no employee is entitled to severance pay or other benefits following termination or resignation, except as otherwise provided by Law.

(c) Seller has delivered to Purchaser accurate and complete copies of all employee manuals and handbooks, policy statements and other documents in Seller's possession relating to the terms and conditions of employment of the current Project Employees.

(d) Schedule 4.21(d) sets forth the name of, and a general description of the services performed by, each independent contractor to whom Seller has made any payment in excess of $50,000 in the aggregate since January 1, 2003 for services rendered in respect of the Project.

4.22 *Employee Benefits*. Set forth on Schedule 4.22 is a complete and correct list of all Benefit Plans currently in effect with respect to the Project Employees. With respect to any "employee benefit plan," within the meaning of Section 3(3) of ERISA, that is sponsored, maintained or contributed to, or has been sponsored, maintained or contributed to within six (6) years prior to the Agreement Date, by any ERISA Affiliate, (a) no withdrawal liability, within the meaning of Section 4201 of ERISA, has been incurred, which withdrawal liability has not been satisfied, (b) no liability to the Pension Benefit Guaranty Corporation has been incurred by any such entity, which liability has not been satisfied, (c) no accumulated funding deficiency, whether or not waived, within the meaning of Section 302 of ERISA or Section 412 of the Code has been incurred, and (d) all contributions (including installments) to such plan required by Section 302 of ERISA and Section 412 of the Code have been timely made.

4.23 *Improvements*. Except as set forth in Schedule 4.23, Seller has not received any written notices from any Governmental Authority stating or alleging that any Improvements with respect to the Purchased Assets have not been constructed in compliance with applicable Law. Except as set forth in Schedule 4.23, no written notice has been received by Seller from any Governmental Authority requiring or advising as to the need for any repair, alteration, restoration or improvement of the Purchased Assets.

ARTICLE V

REPRESENTATIONS AND WARRANTIES OF PURCHASER

Effective as of the Agreement Date and the Closing Date, Purchaser hereby represents and warrants to Seller that:

5.1 *Corporate Existence*. Purchaser is a corporation duly organized, validly existing and in good standing under the Laws of the State of Arizona and has all requisite corporate power and authority to enter into this Agreement and each of the Ancillary Agreements to which it is a party, to perform its obligations hereunder and thereunder and to consummate the transactions contemplated hereby and thereby. Purchaser is duly qualified or licensed to do business in each other jurisdiction where the nature of its business or the actions required to be performed by it hereunder makes such qualification or licensing necessary, except in those jurisdictions where the failure to be so qualified or licensed would not reasonably be expected to result in a material adverse effect on Purchaser's ability to perform its obligations hereunder. Purchaser has made available to Seller true, correct and complete copies of Purchaser's Charter Documents.

5.2 *Authority*. Purchaser has all requisite corporate power and authority to execute and deliver this Agreement and each of the Ancillary Agreements to which it is a party, to perform its obligations hereunder and thereunder and to consummate the transactions contemplated hereby and thereby. The execution and delivery by Purchaser of this Agreement and each of the Ancillary Agreements to which Purchaser is a party and the performance by Purchaser of its obligations hereunder and thereunder have been duly and validly authorized by all corporate action on behalf of Purchaser. This Agreement and each of the Ancillary Agreements to which Purchaser is a party have been duly and validly executed and delivered by Purchaser and constitute the legal, valid and binding obligation of Purchaser enforceable against Purchaser in accordance with their respective terms except that the enforcement hereof and thereof may be limited by bankruptcy, insolvency, reorganization, arrangement, moratorium or other similar Laws relating to or affecting the rights of creditors generally, or by general equitable principles.

5.3 *No Conflicts*. The execution, delivery, and performance by Purchaser of this Agreement and each of the Ancillary Agreements to which Purchaser is a party and the completion of the transactions contemplated hereby and thereby do not and will not:

(a) conflict with or result in a violation or breach of any of the terms, conditions or provisions of Purchaser's Charter Documents;

(b) violate, result in a breach of, constitute (with due notice or lapse of time or both) a default or cause any obligation, penalty, premium or right of termination, cancellation or acceleration to arise or accrue under, any Contract to which Purchaser is a party or by which it or any of its Assets may be bound, except for any such defaults or consents (or rights of termination, cancellation or acceleration) as to which requisite waivers or consents have been obtained or which would not, individually or in the aggregate, reasonably be expected to have a Purchaser Material Adverse Effect; or

(c) assuming all required filings, approvals, consents, authorizations and notices set forth in Schedule 5.3(c) (collectively, the "*Purchaser Approvals*") have been made, obtained or given, (i) conflict with or result in a material violation or breach of any term or provision of any Law or writ, judgment, order or decree applicable to Purchaser or its Assets, or (ii) require the consent, approval, or notification of, or registration or filing with, any Governmental Authority under any applicable Law, except for any such consents, approvals, notifications, registrations or filings which would not, individually or in the aggregate, reasonably be expected to have a Purchaser Material Adverse Effect.

5.4 *Legal Proceedings*. Neither Purchaser nor any of its Affiliates has been served with notice of any Claim, and, to Purchaser's Knowledge, none has been threatened against any such Person, that (a) affects Purchaser or its Assets and would, individually or in the aggregate, if pursued or resulting in a judgment against Purchaser, reasonably be expected to have a Purchaser Material Adverse Effect or (b) seeks a writ, judgment, order or decree restraining, enjoining or otherwise prohibiting or making illegal any of the transactions contemplated by this Agreement. Purchaser does not have any Knowledge of any facts that would reasonably be expected to form the basis for any such Claim, writ, judgment, order or decree. For purposes of this Agreement, "*Purchaser's Knowledge*" means the actual knowledge of the individuals named on Schedule 5.4, who Purchaser represents to be the persons generally responsible for the subject matters to which such knowledge is pertinent.

5.5 *Compliance with Laws and Orders*. Purchaser is in compliance with all Laws and orders applicable to Purchaser or its Assets, except where any non-compliance would not, in the aggregate, reasonably be expected to have a Purchaser Material Adverse Effect.

5.6 *Brokers*. Purchaser does not have any liability or obligation to pay fees or commissions to any broker, finder or agent with respect to the transactions contemplated by this Agreement for which Seller could become liable or obligated.

5.7 *Financial Resources*. Subject to Purchaser's receipt of the ACC Order, Purchaser has cash or credit available, and will have cash available at the Closing, to enable it to purchase the Purchased Assets on the terms hereof.

ARTICLE VI

COVENANTS

6.1 *Regulatory and Other Approvals*.

(a) Seller covenants that, from the date hereof until the earlier of the Closing or termination of this Agreement in accordance with its terms (the "*Interim Period*"), Seller will, in order to consummate the transactions contemplated hereby (including the transfer of the Transferred Permits to Purchaser), take such reasonable steps as are necessary or desirable, and proceed diligently and in good faith and use all reasonable efforts to expedite and obtain the Seller Approvals and Seller Consents, and to make all filings with, and to give all notices to, Governmental Authorities, and provide such other information and communications to such Governmental Authorities or other Persons, as such Governmental Authorities or other Persons

may reasonably request in connection therewith. Purchaser covenants that, during the Interim Period, Purchaser will, in order to consummate the transactions contemplated hereby (including the transfer of the Transferred Permits to Purchaser), take such reasonable steps as are necessary or desirable, and proceed diligently and in good faith and use all reasonable efforts to expedite and obtain the Purchaser Approvals, and to make all filings with, and to give all notices to, Governmental Authorities, and provide such other information and communications to such Governmental Authorities or other Persons, as such Governmental Authorities or other Persons may reasonably request in connection therewith. Without limiting the generality of the foregoing, each Party shall provide, and cause its respective Affiliates to provide, true and accurate information in a timely manner with respect to all filings with and notices to Governmental Authorities. Nothing in this **Section 6.1(a)** shall be construed to require (i) Purchaser to take any action with respect to filings with or notices to Governmental Authorities that in Purchaser's discretion could materially adversely affect any other proceeding with such Governmental Authorities or (ii) Seller to take any action that would result in the transfer of a Permit to Purchaser prior to Closing. Each Party will cooperate fully in good faith with the other Party with respect to all filings that are required by Law or that such other Party elects to make in connection with the transactions contemplated under this Agreement. Each Party will also cooperate fully in good faith with the other in obtaining all material consents and approvals required under this Agreement.

(b) Each Party will provide the other Party with a reasonable opportunity to review and provide prior comment upon any notices, filings or other submissions that the Party plans to deliver or submit to any Governmental Authority, and will promptly provide to such other Party a copy of any such notices or filings. Notwithstanding the foregoing, the Parties recognize that as a result of the short time frames available for the preparation and filing of many documents required to be filed in the proceedings seeking the ACC Order, each Party may be able to afford the other Party only a very brief opportunity for prior review of or comment on filings in such proceedings. Each Party will provide prompt notification to the other Party when any approval referred to in **Section 6.1(a)** is obtained, taken, made or given, as applicable, and will advise the other Party of any material communications with any Governmental Authority from which such approval is required regarding any pending application or request for approval by such Governmental Authority of any of the transactions contemplated by this Agreement.

(c) Each Party shall prepare, as soon as is reasonably practicable following the execution of this Agreement, all necessary filings in connection with the transactions contemplated by this Agreement that may be required to be made by such Party at FERC or under the HSR Act. Each Party shall submit such filings as soon as practicable, but, in the case of filings under the HSR Act, in no event later than thirty (30) days after the date that the Parties file their application with FERC, under Section 203 of the Federal Power Act of 1935, and Part 33 of the FERC Regulations (18 CFR Part 33), for the approval of the transactions contemplated by this Agreement. Unless the Parties agree otherwise at the time of filing, the Parties shall request expedited treatment of filings at FERC and early termination of the waiting period under the HSR Act. The Parties shall promptly make any appropriate or necessary subsequent or supplemental filings and shall cooperate in the preparation of such filings as is reasonably necessary and appropriate.

(d) To the extent that any Transferred Contract or Transferred Permit is not assignable without the consent of another party, then this Agreement shall not constitute an assignment or attempted assignment thereof if such assignment or attempted transfer thereof would constitute a breach thereof or a default thereunder. Without limiting the provisions of **Section 6.1(a)**, if any such consent shall not be obtained, or if any attempted assignment of a Transferred Contract or Transferred Permit would be ineffective or would impair Purchaser's rights and obligations such that Purchaser would not in effect acquire the benefit of substantially all of such rights and obligations, Seller shall cooperate with Purchaser in any reasonable arrangement, to the extent legally permissible, designed to provide for Purchaser the benefits intended to be assigned to Purchaser under the Transferred Contract or Transferred Permit, including enforcement at the cost and for the account of Purchaser of any and all rights of Seller against the other party thereto arising out of the breach or cancellation thereof by such party or otherwise. If and to the extent that such arrangement is not made in a manner reasonably satisfactory to Purchaser, Purchaser shall have no obligation pursuant to **Section 2.3** or otherwise with respect to such Transferred Contract or Transferred Permit. The provisions of this **Section 6.1(d)** shall not affect the right of Purchaser not to consummate the transactions contemplated by this Agreement if the conditions to Purchaser's obligations set forth in **Section 8.5** have not been fulfilled.

6.2 ***Access of Purchaser.*** Seller covenants that, during the Interim Period, Seller will provide Purchaser and its Representatives with reasonable access, upon reasonable prior notice and during normal business hours, to the Project, all Contracts to which Seller is a party related to the Project or the Business or by which the Purchased Assets are bound, all Books and Records, including all environmental records, permits, and compliance audits relating to the Business or the Project, and the officers and employees of Seller or its Affiliates who have significant responsibility for Seller, but only to the extent that such access does not unreasonably interfere with the Business of Seller and that such access is reasonably related to the Purchaser's obligations and rights hereunder; provided that Seller shall have the right to (i) have a Representative of Seller present for any communication with employees or officers of Seller or its Affiliates and (ii) impose reasonable restrictions and requirements upon Purchaser and its Representatives for safety purposes. Purchaser shall be entitled, at its sole cost and expense, to have the Real Property surveyed and to conduct physical inspections (including invasive testing procedures) of the Real Property. Purchaser shall provide Seller with not less than five (5) Business Days prior written notice of the date and time on which any such entry upon the Real Property is proposed to occur. Promptly upon completion of any such entry, Purchaser shall, at its sole cost and expense, repair any and all damage caused by such entry and restore any affected Real Property and any other affected property to its original condition. Purchaser hereby agrees to indemnify, defend and hold harmless Seller and its Representatives and Affiliates from and against any and all Losses, whether or not involving a third-party Claim, resulting from or arising out of or in connection with any entry upon the Real Property by Purchaser or any of its Affiliates or any of its or their respective Representatives, agents, contractors or subcontractors pursuant to this **Section 6.2**. The provisions of this **Section 6.2** shall apply to the access and inspection by Purchaser of any and all portions of the Real Property leased by Seller to Marcus D. Martin d/b/a Marcus D. Martin Farms under the Martin Farms Lease. In addition to complying with the notice, repair and other provisions of this Section, Purchaser shall comply with any and all additional requirements set forth in the Martin Farms Lease, and any access and inspection by Purchaser to the portions of the Real Property leased

under the Martin Farms Lease shall be subject to the rights of the tenant under such lease. Without limiting the foregoing, Seller shall take all actions that are reasonably necessary and appropriate to assist Purchaser in gaining access to and inspecting such portions of the Real Property in accordance with the terms and conditions of this Section.

6.3 *Certain Restrictions*. Seller covenants that, except as set forth in Schedule 6.3, during the Interim Period, Seller will operate and maintain the Business and the Purchased Assets in the usual and ordinary course consistent with Good Operating Practices. Without limiting the foregoing, during the Interim Period, Seller will not, without the prior consent of Purchaser, which consent shall not be unreasonably withheld or delayed:

(a) permit, allow, or suffer to exist any Lien (other than a Permitted Lien) against any of the Purchased Assets;

(b) grant any waiver of any material term under, or give any material consent with respect to, any Material Contract;

(c) sell, lease (as lessor), transfer, convey or otherwise dispose of any Purchased Assets (including by way of merger, liquidation or dissolution) having an aggregate value in excess of $50,000, other than Purchased Assets used, consumed or replaced in the ordinary course of business consistent with Good Operating Practices or Purchased Assets which are replaced prior to the Closing;

(d) other than trade payables incurred in the ordinary course of business or accounts payable pursuant to any Contract, incur, create, assume or otherwise become liable for indebtedness or issue any debt securities or assume or guarantee the obligations of any other Person;

(e) change any accounting method or practice in a manner that is inconsistent with past practice except as may be required to meet the requirements of applicable Law or GAAP, in a way that would adversely affect the Business or Seller;

(f) fail to maintain its limited liability company existence or consolidate with any other Person or acquire all or substantially all of the Assets of any other Person;

(g) issue or sell any limited liability company membership interests;

(h) liquidate, dissolve, recapitalize, reorganize, or otherwise wind up its business or operations;

(i) purchase any securities of any Person, except for short-term investments made in the ordinary course of business;

(j) enter into, terminate, extend or amend any Contract involving total consideration throughout its term in excess of $100,000 (other than Contracts entered into in the ordinary course which will be fully performed prior to Closing);

(k) cancel any debts or waive any claims or rights with respect to the Purchased Assets having a value, individually or in the aggregate, in excess of $100,000;

(l) enter into any collective bargaining or labor agreement;

(m) make any material election with respect to Taxes;

(n) amend or modify its Charter Documents;

(o) make any material change in the operations of the Purchased Assets including the levels of inventory and materials and supplies customarily maintained by Seller;

(p) enter into, terminate, extend or amend any real or personal property Tax agreement, treaty or settlement, except as required by applicable Law;

(q) execute, enter into, terminate, extend or amend any agreement, order, decree or judgment relating to any material Permit, except as required by applicable Law or (in any case other than termination) except in the ordinary course of business consistent with past practices;

(r) prohibit payment of or delay payment of or prohibit or delay discharge of any Liability that will be an Assumed Liability; or

(s) agree or commit to do any of the foregoing.

Notwithstanding the foregoing, Seller may take commercially reasonable actions with respect to emergency situations so long as Seller shall, upon receipt of notice of any such actions, promptly inform Purchaser of any such emergency actions taken outside the ordinary course of business.

6.4 *Further Assurances*. Subject to the terms and conditions of this Agreement, each Party shall, upon request by the other Party at any time, or from time to time, after the Closing, and without further consideration, execute and deliver to such other Party such other instruments of sale, transfer, conveyance, assignment and confirmation, provide such materials and information and take such other actions as such other Party may reasonably request in order to consummate the transactions contemplated by this Agreement.

6.5 *Employee and Employee Benefit Matters*.

(a) Schedule 6.5(a) sets forth a list of Project Employees that Seller and such Affiliates will make available to Purchaser at least thirty (30) Business Days before the Closing Date (the *"Available Employees"*) for the purpose of discussing potential employment with Purchaser (which discussions the Parties agree shall not violate Section 12.5), together with each such Available Employee's name, current annual base compensation, job title, work location, hire date, vacation balance and sick leave balance, as of the date hereof. Prior to the Closing Date, Purchaser may make an offer of employment to any Available Employee, and each such offer shall include terms and provisions determined by Purchaser that are consistent with the provisions of this Section 6.5; provided, that subject to the following provisions of this Section 6.5, the foregoing shall not be construed to prevent Purchaser from changing the terms

and conditions of employment of any Continued Employee (as hereinafter defined) following the Closing Date. Seller shall be responsible for, and shall indemnify and hold Purchaser harmless from and against, (i) all severance benefits payable under Seller's applicable severance policies to any Available Employees (or any other employee of Seller or its Affiliates) who do not accept or are not provided with an offer of employment with Purchaser or its Affiliates prior to or at Closing, and (ii) any accrued salary or incentive compensation or outstanding vacation or sick pay balance as of the Closing owing to any employee of Seller or its Affiliates, whether or not any such employee is provided with or accepts an offer of employment with Purchaser or its Affiliates. Purchaser shall be responsible for, and shall indemnify and hold Seller harmless from and against, any Losses caused by or resulting from any failure by Purchaser to offer employment to any Available Employee on any basis prohibited by applicable Law.

(b) On or before five (5) Business Days prior to the Closing Date, Purchaser shall deliver to Seller a Schedule 6.5(b) that sets forth the names of the Available Employees who have agreed to accept employment with Purchaser effective as of the Closing Date (each, a "***Continued Employee***"); provided, that to be a Continued Employee, such employee must (i) accept Purchaser's offer to transfer employment to Purchaser under the terms provided in Purchaser's offer, and (ii) on the Closing Date, be actively at work, on wellness or sickness leave, short-term disability or an approved leave of absence.

(c) Effective as of the Closing Date, the Continued Employees shall cease to participate in all "employee benefit plans" (within the meaning of Section 3(3) of ERISA) of Seller or its Affiliates (the "***Seller Plans***"). Purchaser shall not assume any of the Seller Plans.

(d) From and after the Closing Date, Purchaser shall cause each Continued Employee to be provided with compensation and benefits on a basis substantially similar to those provided to similarly situated employees of Purchaser and its Affiliates. Purchaser shall cause each Continued Employee and his or her "eligible dependents" (as defined by the applicable group health plan of Purchaser or its Affiliates) to be covered under a group health plan maintained by Purchaser or an Affiliate of Purchaser that (i) provides medical benefits to the Continued Employee and such eligible dependents effective immediately upon the Closing Date and (ii) credits such Continued Employee and such eligible dependents, for the year during which such coverage under such group health plan begins, with any deductibles and co-payments already incurred during such year under a group health plan maintained by Seller or an Affiliate of Seller (provided, that for purposes of applying this clause (ii) with respect to any Continued Employee or eligible dependent, the Continued Employee or eligible dependent, as applicable, shall be responsible for providing the necessary information to Purchaser based on explanation of benefit forms received by the Continued Employee or the eligible dependent from the group health plan maintained by Seller or an Affiliate of Seller). Purchaser shall cause the employee benefit plans and programs maintained after the Closing by Purchaser and the Affiliates of Purchaser to recognize each Continued Employee's years of service and level of seniority prior to the Closing Date with Seller and the Affiliates of Seller for purposes of terms of employment and eligibility and vesting under such plans and programs (other than benefit accruals under any defined benefit pension plan). Purchaser shall cause each employee welfare benefit plan or program sponsored by Purchaser or an Affiliate of Purchaser in which the Continued Employees may be eligible to participate on or after the Closing Date to waive any preexisting condition

exclusion with respect to participation and coverage requirements applicable to Continued Employees and their eligible dependents.

(e) Claims of Continued Employees and their eligible beneficiaries and dependents for medical, dental, prescription drug, life insurance, or other welfare benefits ("*Welfare Benefits*") (other than disability benefits) that are incurred before the Closing Date shall be the responsibility solely of Seller and the Seller Plans. Claims of Continued Employees and their eligible beneficiaries and dependents for Welfare Benefits (other than disability benefits) that are incurred from and after the Closing Date shall be the responsibility solely of Purchaser and its Affiliates. For purposes of this paragraph, a medical/dental claim shall be considered incurred on the date when the medical/dental services are rendered or medical/dental supplies are provided, and not when the condition arose or when the course of treatment began. Claims of individuals receiving long-term disability benefits under a Seller Plan as of the Closing Date shall be the responsibility solely of Seller and the Seller Plans. Except as provided in the preceding sentence, claims of Continued Employees and their eligible beneficiaries and dependents for short-term or long-term disability benefits from and after the Closing Date shall be the responsibility solely of Purchaser and its Affiliates (without regard to whether the circumstances giving rise to such claim occurred before, on or after the Closing Date).

(f) All claims for health care and dependent care flexible spending account benefits submitted on or after the Closing Date for expenses incurred prior to the Closing Date by Continued Employees shall be paid by Seller's or its Affiliates' health care and dependent care flexible spending account plan to the extent permitted in accordance with the terms of such plan.

(g) Claims for workers' compensation benefits arising out of occurrences prior to the Closing Date shall be the responsibility of Seller. Claims for workers' compensation benefits for Continued Employees arising out of occurrences on or after the Closing Date shall be the responsibility of Purchaser.

6.6 *Insurance*. Seller shall maintain or cause to be maintained the insurance policies (or reasonably equivalent renewals or replacements thereof) covering the Project until the Closing. Neither Seller nor any of its Affiliates shall have any liability for any claims made or reported under such insurance policies after the Closing.

6.7 *Seller's Covenants and Closing Conditions*. Except as contemplated by this Agreement or with the prior written consent of Purchaser, during the Interim Period Seller shall use commercially reasonable efforts to:

(a) take all actions that are reasonably necessary or appropriate to ensure that the representations and warranties in **Article IV** hereof remain true and correct in all respects at the Closing;

(b) promptly advise Purchaser of any facts of which Seller has Knowledge that would cause any of Seller's representations and warranties to be untrue or would make the satisfaction of the conditions in **Article VIII** impossible or unlikely; and

(c) bring about, as soon as practical after the date hereof, the satisfaction of all the conditions set forth in **Article VIII**.

6.8 *Purchaser's Covenants and Closing Conditions*. Except as contemplated by this Agreement or with the prior written consent of Seller, during the Interim Period Purchaser shall use commercially reasonable efforts to:

(a) take all actions that are reasonably necessary or appropriate to ensure that the representations and warranties in **Article V** remain true and correct in all material respects at the Closing;

(b) promptly advise Seller of any facts of which Purchaser has Knowledge that would cause any of Purchaser's representations and warranties to be untrue or would make the satisfaction of the conditions in **Article IX** impossible or unlikely; and

(c) bring about, as soon as practical after the date hereof, the satisfaction of all the conditions set forth in **Article IX**.

6.9 *Exclusivity*. Seller covenants that it will not, and will not cause or permit its Affiliates or any of their respective Representatives to, directly or indirectly, (a) discuss, negotiate, undertake, authorize, recommend, propose or enter into, either as the proposed surviving, merged, acquiring or acquired entity, any transaction involving a merger, consolidation, business combination, purchase or disposition of any of the Purchased Assets or any equity interest in Seller other than the transactions contemplated by this Agreement and the Ancillary Agreements (an "***Acquisition Transaction***"), (b) facilitate, encourage, solicit or initiate discussions, negotiations or submissions of proposals or offers in respect of an Acquisition Transaction, (c) furnish or cause to be furnished, to any Person, any information concerning the business, operations, properties or Assets of Seller in connection with an Acquisition Transaction, or (d) otherwise cooperate in any way with, or assist or participate in, facilitate or encourage, any effort or attempt by any other Person to do or seek any of the foregoing; provided, however, that Affiliates of the Seller may engage in discussions or negotiations with, or furnish information concerning the Seller and its properties, assets and business to, any person which makes, or indicates in writing an intention to make, a proposal for an Acquisition Transaction if the Board of Directors of such Affiliate shall conclude in good faith on the basis of the advice of its outside counsel that the failure to take such action would violate the fiduciary obligations of such Board of Directors under applicable Law. Seller will inform Purchaser in writing immediately following the receipt by Seller, its Affiliates or any Representative of any substantial written proposal in respect of any Acquisition Transaction. Notwithstanding the foregoing, and without limiting the provisions of **Section 6.3**, Seller shall be entitled from time to time and at any time prior to the Closing, without obligation of or liability to Purchaser, to market, sell and deliver capacity and energy products and services from the Project and any portion thereof for a term or terms ending not later than the Closing.

6.10 *Risk of Loss*.

(a) From the date hereof until the Closing, all risk of loss or damage to the property included in the Purchased Assets shall be borne by Seller.

(b) If, before the Closing any or all of the Purchased Assets are taken by eminent domain, or are the subject of a pending or, to Seller's Knowledge, contemplated taking or condemnation which has not been consummated, Seller shall notify Purchaser promptly in writing of such fact.

(i) If such taking would reasonably be expected to have a Seller Material Adverse Effect, Purchaser and Seller shall negotiate in good faith to settle the loss resulting from such taking or condemnation (including by making a fair and equitable adjustment to the Purchase Price) and, upon such settlement, consummate the transactions contemplated by this Agreement pursuant to the terms of this Agreement. If no such settlement is reached within sixty (60) days after Seller has notified Purchaser of such taking or condemnation, then Purchaser or Seller may, if such taking relates to the Purchased Assets, terminate this Agreement pursuant to **Section 10.1(h)** hereof.

(ii) If such taking or condemnation would not reasonably be expected to have a Seller Material Adverse Effect, Purchaser and Seller shall negotiate in good faith to settle the loss resulting from such taking or condemnation (including by making a fair and equitable adjustment to the Purchase Price or by transferring certain rights to the condemnation award, if any, to Purchaser) and, upon such settlement, consummate the transactions contemplated by this Agreement pursuant to the terms of this Agreement.

(c) If, before the Closing, all or any material portion of the Purchased Assets are damaged or destroyed by fire or other casualty, Seller shall notify Purchaser promptly in writing of such fact.

(i) If such damage or destruction would reasonably be expected to have a Seller Material Adverse Effect and Seller has not notified Purchaser of its intention to cure such damage or destruction within thirty (30) days after the occurrence of such damage or destruction, Purchaser and Seller shall negotiate in good faith to settle the loss resulting from such casualty (including by making a fair and equitable adjustment to the Purchase Price) and, upon such settlement, consummate the transactions contemplated by this Agreement pursuant to the terms of this Agreement. If no such settlement is reached within sixty (60) days after Seller has notified Purchaser of such casualty, then Purchaser or Seller may terminate this Agreement pursuant to **Section 10.1(h)** hereof.

(ii) If such damage or destruction would not reasonably be expected to have a Seller Material Adverse Effect and Seller has not notified Purchaser of its intention to cure such damage or destruction within thirty (30) days after the occurrence of such damage or destruction, Purchaser and Seller shall negotiate in good faith to settle the loss resulting from such casualty (including by making a fair and equitable adjustment to the Purchase Price or by transferring certain rights to insurance proceeds, if any, to Purchaser) and, upon such settlement, consummate the transactions contemplated by this Agreement pursuant to the terms of this Agreement.

(d) If the Parties fail to reach a settlement contemplated by Section 6.10(b)(ii) or Section 6.10(c)(ii) hereof, as applicable, within thirty (30) days after Seller has notified Purchaser of such taking or casualty, as the case may be, then the Purchase Price shall be adjusted downward by the amount of the fair market value of the portion of the Purchased Assets subject to the taking, condemnation or casualty loss, as determined by Independent Accountants for review and final determination of such fair market value. The Independent Accountants may request of Seller or Purchaser such documents and information as may be necessary or appropriate for proper determination of any such matter, and such Parties will cooperate to promptly satisfy any such request. The Independent Accountants shall be instructed to deliver to Purchaser and Seller a written determination of the fair market value within thirty (30) days from the date of referral thereof to the Independent Accountants. Except in the case of fraud or manifest error, the determination by the Independent Accountants of such fair market value will be final and binding on the Parties. Seller and Purchaser will equally share the fees and disbursements of the Independent Accountants in undertaking such review and determination.

6.11 *Current Evidence of Title.*

(a) As soon as is reasonably possible after the Agreement Date, and in no event later than thirty (30) Business Days after the Agreement Date, Seller shall furnish to Purchaser, for each parcel, tract or subdivided land lot of Real Property set forth on Schedule 4.13(a):

(i) from Stewart Title Guaranty Company (the "*Title Insurer*"):

(A) title commitments issued by the Title Insurer to insure title to all Real Property and Improvements in the amount of that portion of the Purchase Price allocated to the Real Property, covering such Real Property, naming Purchaser as the proposed insured and having an effective date after the Agreement Date, wherein the Title Insurer shall agree to issue, an ALTA 1992 form owner's extended coverage policy of title insurance (each a "*Title Commitment*"); and

(B) complete and legible copies of all documents listed or disclosed in Schedule B to the Title Commitment (the "*Title Exception Documents*"); and

(ii) at Purchaser's cost and expense, a survey of the Real Property made after the Agreement Date by a land surveyor licensed by the State of Arizona and bearing a certificate, signed and sealed by the surveyor, certifying to Seller, Purchaser and the Title Insurer that:

(A) such survey was made (1) in accordance with "*Minimum Standard Detail Requirements for ALTA/ACSM Land Title Surveys*," jointly established and adopted by ALTA and ACSM in 1992, and includes Items 1-4, 6, 7(a), 7(b)(1), 7(c), 8-11 and 13 of Table A thereof, and (2) pursuant to the Accuracy Standards (as

adopted by ALTA and ACSM and in effect on the date of said certificate) of an "Urban" survey; and

(B) such survey reflects the locations of all building lines, easements and areas affected by any Title Exception Documents affecting such Real Property as disclosed in the Title Commitment (identified by issuer, commitment number, and an effective date after the date hereof) as well as any encroachments onto the Real Property or by the Improvements onto any easement area or adjoining property (each a "***Survey***"); and

(iii) The Title Commitment shall include the Title Insurer's standard requirements for issuing its title policy, which requirements, to the extent applicable to Seller, shall be met by Seller on or before the Closing Date (including those requirements that must be met by releasing or satisfying monetary Liens, but excluding requirements that are to be met solely by Purchaser).

(iv) Seller shall pay the premium for a standard form owner's policy. Purchaser shall be responsible for the difference in premium between standard and extended coverage and for other endorsements and any other costs and expenses of such policy of title insurance.

(b) If any of the following shall occur:

(i) any Title Commitment or other evidence of title or search of the appropriate real estate records discloses that any party other than Seller has title to the insured estate covered by the Title Commitment;

(ii) any title exception is disclosed in Schedule B to the Title Commitment that (A) is not one of the Permitted Liens and (B) Purchaser reasonably believes could have a material adverse effect on Purchaser's use and enjoyment of the Real Property described therein; or

(iii) any Survey discloses any matter that Purchaser reasonably believes could have a material adverse effect on Purchaser's use and enjoyment of the Real Property described therein;

then Purchaser shall notify Seller in writing ("***Purchaser's Notice***") of such matters (any such matter of which Purchaser so provides Purchaser's Notice to Seller, a "***Title Objection***") within thirty (30) Business Days after receiving all of the Title Commitment, Survey and copies of Title Exception Documents for the Real Property covered thereby. Any such matter of which Purchaser fails to provide Purchaser's Notice to Seller within such period shall not constitute a Title Objection and shall be deemed to be acceptable to Purchaser and constitute a Permitted Lien for purposes of this Agreement.

(c) Seller shall have ten (10) Business Days after receipt of Purchaser's Notice to notify Purchaser that either (i) Seller has elected to remove any Title Objection(s) from

the title and provide Purchaser with evidence reasonably satisfactory to Purchaser of such removal, or provide Purchaser with evidence reasonably satisfactory to Purchaser that said exceptions will be removed on or before the Closing, or (ii) Seller has elected not to remove such Title Objections. Notwithstanding the provisions to the contrary contained in this **Section** 6.11(c), Seller shall remove all liens, mortgages, deeds of trust or other monetary liens and encumbrances (other than non-delinquent real estate taxes for the current year or special assessments or local improvement district assessments payable in installments which shall be paid or prorated to the Closing Date as provided in **Section 3.2**) prior to or upon Closing. If Seller gives Purchaser notice under the foregoing clause (ii), Purchaser shall have ten (10) Business Days to elect to proceed with the purchase and take the Real Property subject to such Title Objections (which exceptions shall then constitute Permitted Liens), or to terminate this Agreement. If Purchaser shall fail to give Seller written notice of such election within said ten (10) Business Days, Purchaser shall be deemed to have waived any and all such Title Objections. If Seller shall give notice pursuant to the foregoing clause (i), Seller shall use commercially reasonable efforts to cure each Title Objection which is the subject of such notice prior to the Closing and take all steps required by the Title Insurer to eliminate each Title Objection as an exception to the Title Commitment. In the event that Seller shall thereafter fail to remove any such Title Objections from title prior to the Closing Date, and Purchaser is unwilling to take title subject thereto, Purchaser may elect to terminate this Agreement, and in the event of any such termination, Seller shall be liable for payment of all title cancellation charges. Any Title Objection that the Title Company is willing to insure over on terms acceptable to Seller and Purchaser is herein referred to as an "***Insured Exception***." The Insured Exceptions, together with any title exception or matters disclosed by the Survey not objected to by Purchaser in the manner aforesaid, shall be deemed to be acceptable to Purchaser and shall constitute a Permitted Lien for purposes of this Agreement.

(d) Nothing herein waives Purchaser's right to claim a breach of **Section 4.13** or to claim a right to indemnification as provided in **Article XI** if Purchaser suffers Losses as a result of a misrepresentation with respect to the condition of title to the Real Property.

6.12 ***Transition Plan.*** Within ten (10) Business Days after the Agreement Date, Purchaser shall deliver to Seller a list of its proposed representatives to a joint transition team. Seller will add its representatives to such team within five (5) Business Days after receipt of Purchaser's list. Such team will be responsible for preparing as soon as reasonably practicable after the Agreement Date, and timely implementing, a transition plan which will identify and describe substantially all of the various transition activities that the Parties will cause to occur before and after the Closing and any other transfer of control matters that any Party reasonably believes should be addressed in such transition plan. If requested by either Party, the terms and conditions governing such transition activities will be more fully set forth in a transition agreement reasonably satisfactory to the Parties. Purchaser and Seller shall use commercially reasonable efforts to cause their representatives on such transition team to cooperate in good faith and take all reasonable steps necessary to develop a mutually acceptable transition plan by no later than sixty (60) days after the Agreement Date.

6.13 *Updating.*

(a) Each Party shall, from time to time prior to the Closing by written notice to the other Party, supplement or amend the Schedules to this Agreement to correct any matter that constitutes a breach of any representation or warranty made by such Party in **Article IV** or **Article V**, as the case may be, as of the Agreement Date. In the event that at any time either Party supplements or amends any Schedule pursuant to this **Section 6.13(a)**, such Party shall: (i) concurrently with a notice provided to the other Party containing such supplement or amendment, specifically identify and provide a detailed description (including any supporting information, materials and data) of the breach such supplement or amendment is proposed to cure reasonably sufficient to enable the other Party to make an informed decision with respect to the consequences of such breach and (ii) promptly, and in any event within two (2) Business Days of the request of the other Party, provide the other Party with any additional information, materials and data relating to such breach as may be reasonably requested by the other Party. Provided that the foregoing shall have been complied with, any such supplement or amendment shall, unless the other Party objects thereto in writing within a period of fifteen (15) Business Days after notice of such supplement or amendment, be deemed to cure, effective as of the Agreement Date, any applicable inaccuracy in such representation or warranty to the extent (and only to the extent) such inaccuracy has been specifically detailed as provided above, and to constitute a waiver by such other Party of any applicable breach of or default under this Agreement. Notwithstanding the foregoing, any such waiver shall not apply to the conditions set forth in **Section 8.6** or **Section 9.6** and no retroactive effect shall be given to any such supplement or amendment for purposes of any determination as to the magnitude of, as the case may be, (1) any change in the Purchased Assets after the Agreement Date that, individually or in the aggregate with other such changes, has, or could reasonably be expected to have, a Seller Material Adverse Effect, or (2) any change in the business, assets, operations, property, performance or condition (financial or otherwise) of Purchaser after the Agreement Date which, individually or in the aggregate with other such changes, has, or could reasonably be expected to have, a Purchaser Material Adverse Effect. In the event that the other Party does so object in writing, the applicable Schedule supplement or amendment made pursuant to this **Section 6.13(a)** shall not be deemed to cure any inaccuracy of any representation or warranty made in this Agreement by the Party supplementing or amending such Schedule, and shall not be considered to constitute or give rise to a waiver by the other Party of any condition or obligation set forth in this Agreement.

(b) Each Party shall, from time to time prior to the Closing by written notice to the other Party, supplement or amend the Schedules to this Agreement with respect to any matter arising after the Agreement Date that, if existing at, or occurring on, the Agreement Date, would have been required to be set forth or described on any such Schedule. In the event that at any time either Party supplements or amends any Schedule pursuant to this **Section 6.13(b)**, such Party shall: (i) concurrently with a notice provided to the other Party containing such supplement or amendment, specifically identify and provide a detailed description (including any supporting information, materials and data) of the breach such supplement or amendment is proposed to cure reasonably sufficient to enable the other Party to make an informed decision with respect to the consequences of such breach and (ii) promptly, and in any event within two (2) Business Days of the request of the other Party, provide the other Party with any additional information, materials and data relating to such breach as may be reasonably requested by the

other Party. Any such supplement or amendment shall, effective immediately upon notice thereof to the other Party, be deemed to cure any applicable inaccuracy in such representation or warranty to the extent (and only to the extent) such inaccuracy has been specifically detailed as provided above, and any applicable breach of or default under this Agreement shall be deemed waived; provided that notwithstanding the foregoing, the foregoing waiver shall not apply to the conditions set forth in **Section 8.6** or **Section 9.6** and no retroactive effect shall be given to any such supplement or amendment for purposes of any determination as to the magnitude of, as the case may be, (1) any change in the Purchased Assets after the Agreement Date that, individually or in the aggregate with other such changes, has, or could reasonably be expected to have, a Seller Material Adverse Effect, or (2) any change in the business, assets, operations, property, performance or condition (financial or otherwise) of Purchaser after the Agreement Date which, individually or in the aggregate with other such changes, has, or could reasonably be expected to have, a Purchaser Material Adverse Effect. In the event that any Schedule to this Agreement is supplemented or amended pursuant to this **Section 6.13(b)**, and the matter with respect to which such Schedule is supplemented or amended causes or results in an expense, fee or other type of cost to either Party, the Parties shall negotiate in good faith to determine how such expense, fee or other costs should fairly and reasonably be apportioned between the Parties. If the Parties are unable reasonably promptly to agree upon such apportionment of such expense, fee or other costs, the Parties' dispute with respect to such apportionment shall be resolved in accordance with the arbitration provisions of **Section 11.6**; provided, however, that if the Parties are unable reasonably promptly to agree upon such apportionment of such expense, fee or other costs, and such expense, fee or other costs must be paid prior to the Closing, the Parties shall, pending the Closing, share such expense, fee or other costs equally so as not to delay or prevent the Closing, subject to reimbursement of any overpayment following resolution of the Parties dispute in accordance with the arbitration provisions of **Section 11.6**.

(c) Each Party shall notify the other Party promptly after becoming aware of any inaccuracy in or breach of any representation or warranty of such other Party under this Agreement.

(d) Without limiting the generality of the foregoing, (i) Seller shall notify Purchaser promptly of the occurrence of any event which, to Seller's Knowledge, could reasonably be expected to result in a Seller Material Adverse Effect, and (ii) Purchaser shall notify Seller promptly of the occurrence of any event which, to Purchaser's Knowledge, could reasonably be expected to result in a Purchaser Material Adverse Effect.

6.14 *Records*.

(a) On the Closing Date or as soon as practicable thereafter, Seller shall deliver or cause to be delivered to Purchaser all original agreements, documents, Books and Records and files, including records and files stored in electronic form (collectively, "***Records***"), if any, in the possession of Seller relating to the Business to the extent not then in the possession of Purchaser, provided that (i) Purchaser recognizes that certain Records may contain incidental information relating to Affiliates of Seller, and that Seller may retain such Records and shall provide copies of the relevant portions thereof to Purchaser and (ii) Records shall not include (A) documents or files relating to employees who are not Continued Employees or (B) employee

documents or files afforded confidential treatment under any applicable Laws, except to the extent the affected employee consents in writing to the disclosure of the same to Purchaser.

(b) Following the Closing, Purchaser shall permit Seller and its Representatives, during normal business hours and upon reasonable notice, to have reasonable access to personnel of Purchaser, and to examine and make copies of, all Records, in each case relating to transactions or events occurring prior to the Closing ("***Pre-Closing Transactions***") or transactions or events occurring subsequent to the Closing that are related to or arising out of Pre-Closing Transactions, to the extent such Pre-Closing Transactions relate to Excluded Liabilities or Excluded Assets or to the extent necessary to comply with applicable financial reporting obligations. Purchaser agrees that it shall retain all such Records for a period of seven (7) years following the Closing, or for such longer period following the Closing as may be required by applicable Law.

6.15 ***Synthetic Lease Transaction.*** Seller represents and warrants that, pursuant to the terms of an Amended and Restated Participation Agreement dated as of July 17, 2001 by and among PPL Large Scale Distributed Generation II, LLC, as Lessee and Supervisory Agent, Large Scale Distributed Generation II Statutory Trust, a Connecticut statutory trust, as Lessor, State Street Bank and Trust Company of Connecticut, National Association, as Trustee, First Union National Bank, as Administrative Agent, certain financial institutions, as Certificate Holders, and certain financial institutions, as Lenders, and various other related agreements, Seller and certain of its Affiliates entered into a synthetic lease arrangement (the "**Synthetic Lease Transaction**") for purposes of financing the acquisition and construction of the Project. The Synthetic Lease Transaction subjects the Purchased Assets to various Liens and leases. Seller covenants and agrees that: (a) prior to the Closing, all right, title and interest in, to and under the Purchased Assets that are the subject of the Synthetic Lease Transaction shall be transferred to Seller; and (b) promptly following such transfer, Seller shall (i) provide notice thereof to Purchaser and (ii) update the Schedules as necessary and appropriate to reflect such transfer. Without limiting the provisions of **Section 2.1**, Seller covenants and agrees that, on the terms and subject to the conditions set forth in this Agreement, Seller shall, at the Closing, sell, assign, convey, transfer and deliver to Purchaser all of Seller's right, title and interest in the Purchased Assets free and clear of any and all Liens and leases (other than Permitted Liens) resulting from or arising out of or in connection with the Synthetic Lease Transaction. The Parties acknowledge and agree that Seller's representations and warranties in this Agreement with respect to the Purchased Assets that are the subject of the Synthetic Lease Transaction contemplate, and are cast as of the time period commencing immediately following, the transfer to Seller of all right, title and interest in, to and under the Purchased Assets that are the subject of the Synthetic Lease Transaction, which transfer shall in any event be effective no later than the Closing.

ARTICLE VII

TAX MATTERS

7.1 *Proration.*

(a) With respect to Taxes to be prorated in accordance with **Section 3.2(a)** hereof only, Purchaser shall prepare and timely file all Tax Returns, if any, required to be filed with respect to the Purchased Assets, and shall duly and timely pay all such Taxes shown to be due on such Tax Returns; provided, however, that Seller shall file all of its federal and state income tax returns (including those reporting prorated income) and shall not be required to permit Purchaser to review or comment on any such income tax returns; provided, further, that any income Tax Returns that report Seller's income shall be prepared in accordance with **Section 3.6** hereof. Purchaser shall make such Tax Returns that it prepares under this **Section 7.1** available for Seller's review and comment no later than sixty (60) days prior to the due date for filing each such Tax Return, and shall not unreasonably refuse to accept any such comments or proposed changes. Within ten (10) days after receipt of such Tax Return, Seller shall pay to Purchaser Seller's proportionate share of the amount shown as due on such Tax Return as determined in accordance with **Section 3.2** hereof.

(b) With respect to Property Taxes to be prorated in accordance with **Section 3.2(b)** hereof only, (i) for all such Property Taxes having a lien date in the year before the calendar year of the Closing Date, Seller shall prepare and timely file all related Property Tax Returns required to be filed with respect to the Purchased Assets and Seller shall duly and timely pay all such Property Taxes; (ii) for all such Property Taxes having a lien date in the same calendar year of the Closing Date, Seller shall prepare and timely file all related Property Tax Returns required to be filed with respect to the Purchased Assets and Seller shall duly and timely pay all such Property Taxes; and (iii) for all such Property Taxes having a lien date in the year after the calendar year of the Closing Date, Seller shall prepare and file when due all related Property Tax Returns required to be filed with respect to the Purchased Assets, except that, if such Property Tax Returns are not due before the Closing Date, Seller shall prepare and file such Property Tax Returns on or before the Closing Date, and in either case Purchaser shall duly and timely pay all such Property Taxes, and shall be reimbursed for a portion thereof in accordance with **Section 3.2(b)(iii)**. Seller shall, in good faith, prepare and timely file any such Property Tax Returns, including any affirmative claims for adjustments, reasonably and in good faith defend the values and adjustments filed, and preserve any and all appeal rights related to such returns. The Parties hereby acknowledge that, without regard to any other provision of this Agreement, all Property Tax Returns, documentation and supporting workpapers relating to any Property Taxes of Seller shall be proprietary to Seller and have not and will not be disclosed to Purchaser; provided, however, that (i) Seller shall, upon request of Purchaser, provide an estimate of Property Taxes to be paid, and (ii) the Party receiving the actual Property Tax bills or statements from the Taxing Authorities shall, upon request from the other Party, provide copies of such Property Tax bills or statements to the requesting Party.

7.2 *Cooperation.* Except as limited by **Section 7.1(b)**, Seller and Purchaser shall provide each other with such assistance as may reasonably be requested by the other Party in connection with the preparation of any Tax Return, any audit or other examination by any